

March 21, 2016

IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft: *Proposed Revisions Pertaining to Safeguards —Phase 1*

INTRODUCTION

The SMP Committee (SMPC) is pleased to respond to the IESBA (the Board) on this Exposure Draft (ED). The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMP Committee are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies representing 18 countries from all regions of the world.

GENERAL COMMENTS

The SMP Committee has followed the Safeguards project and provided comment letters for the Board and Task Force's consideration as it has progressed. Overall, we have been broadly supportive of the general direction and approach. We recognize and appreciate that the Board have acknowledged that SMPs can face distinct practical challenges in applying safeguards, often due to their limited resources. In particular, we look forward to assisting the Board as it considers the unique challenges faced by the SMP sector as part of Phase II of the project.

We believe that flexibility and the ability to exercise professional judgment are extremely important to professional accountants (PAs), no less so SMPs. In this context, we are not convinced that a third party test is necessary in circumstances where the Code requires a PA to exercise professional judgment. However, the so-called third-party test as proposed in R120.4 A1 does seem to make sense in relation to a determination of whether the professional accountant complies with the fundamental principles of the Code. We do not believe that additional third-party tests for specific matters are appropriate elsewhere in the Code beyond this.

It is important that the Board maintains a principles-based approach in proposing changes to the Code in the area of threats and safeguards, and does not seek to impose rigid requirements that may prove difficult for SMPs to readily apply.

We support the Board's intention to consider whether there is a need for alignment to the requirements and application material in ISA 220¹, with respect to documentation of safeguards in the context of audits

¹ International Standard on Auditing (ISA) 220, *Quality Control for the Audit of Financial Statements*



of financial statements in Phase II. However, we suggest that this is a general issue and it should not be confirmed to just a single standard. For example, ISQC 1² and ISA 250³ may need specific consideration.

We note that as part of its future work, the Board plans to consider whether additional guidance is needed in the Code to explain the differences in the evaluation of whether a threat is at an acceptable level for a public interest entity (PIE) and an entity that is not a PIE. This guidance may be particularly helpful for SMPs who primarily service SMEs. In our opinion, as the vast majority of entities across the world are SMEs—reliable sources estimate at least 90%—and account for the majority share of most jurisdictions' private sector employment and GDP, we feel this guidance demands a higher priority.

The SMPC notes that the Board agreed to apply the proposed structure and drafting conventions developed under its Structure of the Code project and a Mapping Table was provided to assist respondents. This document is very helpful, but we found that separating this project from the Structure of the Code project was difficult. It has therefore been necessary to include some comments which will likely be repeated in our comment letter on the Structure of the Code Exposure Draft.

SPECIFIC COMMENTS

We have outlined our responses to each question (*in italics*) in the ED below.

Proposed Revisions to the Conceptual Framework

1. Do respondents support the Board's proposed revisions to the extant Code pertaining to the conceptual framework, including the proposed requirements and application material related to:

- (a) Identifying threats;*
- (b) Evaluating threats;*
- (c) Addressing threats;*
- (d) Re-evaluating threats; and*
- (e) The overall assessment.*

If not, why not?

Overall we support the Board's proposed revisions to the extant Code pertaining to the conceptual framework. However, we believe that the new overarching requirements for all PAs to apply the Conceptual Framework (R120.3 and R300.2) should be replaced with overarching objectives for the PA, which are supported by more specific requirements. This would serve in combination with the requirement for PAs to make an overall assessment of whether or not the objective has been met (similar to R120.9), supported by the explicit requirements and application material. In our opinion, the broad requirements such as those in R120.3 and R300.2 can be difficult in practice (including monitoring compliance etc.). Using more general objectives means the requirements can be more specific and the expected actions are far clearer.

² International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

³ International Standard on Auditing (ISA) 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*



The SMPC agrees that an overall assessment (R120.9) is useful. However, we do not consider that this is necessary for every section of the Code, but only once in total in R120.9. This approach would be similar to the one used in ISA 200⁴, paragraphs 21 and 24.

In the section on Identifying Threats (paragraphs R120.5 and 120.5 A1) it should be recognized that the role and responsibilities of PAs may vary from one jurisdiction to another. For example, the familiarity threat outlined in 120.5A2 may not necessarily be considered a significant problem in certain countries when a professional accountant has been an employee for a long period of time. In our view, the descriptions of threats in the Conceptual Framework should be broad enough to cover PAs both in public practice and in business.

We support the proposed change of approach for how certain conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization can affect compliance with the fundamental principles and can be taken into account when identifying and evaluating threats, as they may potentially reduce or eliminate one or more particular threats. However, we suggest that some clarification may be needed, primarily in relation to safeguard measures beyond those created by the profession or legislation in a particular jurisdiction. For example, clarification of the documentation requirements pertaining to the identification (and non-identification) of threats where the PA intends to rely on safeguards already in place in the work environment and safeguards implemented by the entity.

In our opinion, the Board could consider restructuring R120.7. It should be made clearer that the possible actions addressing the threats in a) and b) are not mutually exclusive actions and could be combined, where appropriate. These could also be distinguished from c) since this is an action of last resort, where services are declined or discontinued because the threat cannot otherwise be reduced. It could be better positioned under 120.7 A1, which may then need to be elevated to a requirement. It should be clear that where the threat is so significant that no safeguards could reduce the threat to an acceptable level, the PA is required to decline or discontinue the specific professional activity or service involved.

In addition, we believe that the Board should add recognition that this may not be possible in some jurisdictions where there may be legislation preventing an auditor from resigning. This recognition could come in the form of “unless precluded from doing so by law or regulation” being added.

Proposed Revised Descriptions of “Reasonable and Informed Third Party” and “Acceptable Level”

2. Do respondents support the proposed revisions aimed at clarifying the concepts of (a) “reasonable and informed third party;” and (b) “acceptable level” in the Code. If not, why not?

We generally agree with the revised description of “Reasonable and Informed Third Party” in particular, that the third party is described as competent by possessing “skills, knowledge and experience”. It may be helpful to stress that hindsight cannot be taken into account if such a test is to be included.

⁴ International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*



The application of this test as proposed in 120.4 A1 in relation to a “stand-back” determination of whether the accountant complies with the fundamental principles of the Code is also considered appropriate. However, as previously stated, we do not believe that additional third-party tests are appropriate elsewhere in the Code.

We agree with the proposed revisions to an “acceptable level” and the inclusion of this as application material in the section on Evaluating Threats. The guidance included in 300.2 A3 with respect to considering whether the audit client is a public interest entity is useful and the Board might wish to consider this in relation to the application material to R120.6.

The SMPC acknowledges that the Board has not used the term “material” or “significant” in proposed sections 120 and 300 as it believes that the meaning of these terms is consistent with the auditing concept of materiality as described by the ISAs and is not appropriate for establishing the overarching requirements and principles about threats and safeguards. However, we wonder whether the term “materiality” is more precise and understandable compared to “quantitative factors” in 120.6 A2, as generally speaking accountants are familiar with this concept.

Proposed Revised Description of Safeguards

3. Do respondents support the proposed description of “safeguards?” If not, why not?

4. Do respondents agree with the IESBA’s conclusions that “safeguards created by the profession or legislation,” “safeguards in the work environment,” and “safeguards implemented by the entity” in the extant Code:

(a) Do not meet the proposed description of safeguards in this ED?

(b) Are better characterized as “conditions, policies and procedures that affect the professional accountant’s identification and potentially the evaluation of threats as discussed in paragraphs 26–28 of this Explanatory Memorandum?”

If not, why not?

We agree that the revised description of safeguards establishes a stronger correlation between “threats and safeguards” and the fundamental principles in the Code. However, the SMPC is concerned about the inclusion of the word “effectively” in place of “may”. We understand the change in emphasis is to reflect that if safeguards are to be effective they should eliminate or reduce the threats to an acceptable level. Nevertheless, for a variety of reasons safeguards themselves may not be a “watertight” response to the threats and we are concerned that the term “effectively” may not be accurate, especially when translated. We suggest the Board uses a different term or clarifies the intended meaning.

We agree with the IESBA’s conclusions that the terms “safeguards created by the profession or legislation”, “safeguards in the work environment” and “safeguards implemented by the entity” do not meet the revised description of safeguards and are better characterized as conditions, policies and procedures that affect the professional accountant’s identification and potentially the evaluation of threats (120.5 A4). In our view, some of the examples in the extant Code are more general conditions to prevent or mitigate against bad practices, rather than actions to be taken by accountants to reduce threats. For instance, “disciplinary procedures” are not a safeguard to manage a detected threat.



Proposals for Professional Accountants in Public Practice

5. Do respondents agree with the IESBA's approach to the revisions in proposed Section 300 for professional accountants in public practice? If not, why not and what suggestions for an alternative approach do respondents have that they believe would be more appropriate?

The SMPC generally agrees with the IESBA's approach to the revisions in proposed Section 300, except for our comment in response to question 1 and our suggestion to replace the broad requirement to comply with each of the fundamental principles and apply the conceptual framework (R300.2) with an objective.

We note that footnote 18 states that the term "professional accountant" refers to professional accountants in public practice and firms of professional accountants in practice. We encourage the Board to consider whether these should be considered on a case by case basis. For example, in some jurisdictions reports may be issued in the name of the firm and in others in the name of an individual.

We acknowledge that with a new introduction, the inclusion of sub-headings and revised drafting, the Board has streamlined and clarified the examples of the types of threats that are included in the extant Code (300.2 A1). One concern raised is whether the removal of certain examples could imply that they are no longer considered a threat. As the Code is intended for global application, it should retain material relevant to jurisdictions where such circumstances may be more commonly encountered.

CONCLUDING COMMENTS

We hope the IESBA finds this letter helpful in informing the Board's deliberations on safeguards. Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Giancarlo Attolini', is written over a horizontal line.

Giancarlo Attolini
Chair, SMP Committee