

March 21, 2016

Chair
International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017

Re: Exposure Draft, Proposed Revisions Pertaining to Safeguards in the Code - Phase 1

Dear Members of the International Ethics Standards Board for Accountants:

We appreciate the opportunity to provide comments on the exposure draft “*Proposed Revisions Pertaining to Safeguards in the Code - Phase 1*” (the “Exposure Draft”) issued December 2015 by the International Ethics Standards Board for Accountants (“IESBA” or “Board”).

General Comments

We support the Board’s objective of maintaining a Code that remains credible and relevant in a constantly evolving global environment. We also recognize the importance of the Board being responsive to regulatory stakeholders if they have expressed concerns that certain safeguards in the Code may be inappropriate or ineffective.

We support the Board’s efforts to bring clarity to the application of safeguards, a fundamentally important aspect of the conceptual framework. We understand the many factors, including the public interest in auditor independence, are driving the Board to consider the practical issues specifically arising from the application of safeguards that pertain to non-audit services, and ensuring that these are understood and applied consistently and appropriately. Nonetheless, we consider that changes to the Code should only be supported by the Board if there is sufficient evidence that the current provisions or safeguards are not effective, and that the potential costs and benefits in making further changes have been appropriately weighed.

The Board notes that the objective of this Exposure Draft is to improve the clarity, appropriateness and effectiveness of safeguards in the Code; however the Board has not set out an analysis in the Exposure Draft to support the rationale for also having reviewed the conceptual framework as a whole.

In its November 2014 Consultation Paper on “Improving the Structure of the Code,” the Board stressed the importance of the requirement to comply with the principles-based conceptual framework. It stated that “IESBA is mindful of the importance of the conceptual framework approach which addresses threats to compliance with the fundamental principles rather than simply complying with rules. IESBA believes that any changes to the structure of the Code should retain the conceptual framework approach.” The conceptual framework is a framework against which the professional accountant can objectively evaluate his or her compliance with the fundamental principles. We consider however that the Board, in making changes to the wording together with the proposed re-structure of these provisions, has transformed the essentially principles-based fabric of the conceptual framework into a rule itself. This is significantly beyond the scope of this project.

The Board appears to be proposing a new rules-based approach to the application of the conceptual framework, predicated on specific activities that the professional accountant must perform. The new requirement in the conceptual framework for the professional accountant to identify threats [*R120.5: The professional accountant shall identify threats...*] followed by several mandatory steps, including the proposed re-evaluation and overall assessment activities, seems to have reduced the conceptual framework to a tactical checklist of compliance activities to be followed by the professional accountant. We believe that this will reduce the strength of the conceptual framework and is not in the public interest.

We also urge the Board to demonstrate that it has balanced the expected incremental benefits of the many concurrent revisions of the Code being exposed, with the potential costs and impacts to the professional accountants who are required to understand and implement them. The current level of change to the Code has the potential for causing confusion for those who are requested to provide comments and ultimately may further inhibit the adoption of the Code.

Our comments to the questions raised in the Exposure Draft are provided below.

Specific Comments

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?

We do not support, as a whole, the proposed revisions to the extant Code pertaining to the conceptual framework as we are unconvinced that the current framework is not effective, and that the potential costs and benefits in making further changes have been appropriately weighed. As noted above, we also consider that the transformation of the conceptual framework into a rules-based approach will have unintended consequences which are not in the public interest.

Subject to our comments above, we do not have any objection to the reorganization of the conceptual framework in line with the objectives of the structure project, however we do not support the addition of the additional Requirements steps (Re-evaluating threats and Overall assessment). See comments below.

Identifying threats

We support any attempt by the Board to provide clearer guidance to assist professional accountants to identify threats and support compliance with the fundamental principles. However some of the proposed provisions have significantly changed the meaning and application of the conceptual framework and we are not supportive of such changes.

The extant Code states that the professional accountant shall apply the conceptual framework to identify and evaluate threats to the fundamental principles and "shall identify" is only used in the independence section. However the Board is proposing to create a "shall" requirement in the framework with respect to identifying threats to the fundamental principles (proposed R.120.5: The professional accountant shall identify threats to compliance with the fundamental principles.) The premise of the conceptual framework is that threats shall be evaluated when they are identified (extant 100.8: "when the professional accountant knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles").

As proposed, the professional accountant is now seemingly required to continually search for all facts and circumstances that may create threats to compliance with the fundamental principles. If this is the intention of the Board (and we would hope it is not), guidance should be provided to assist the professional accountant in understanding what is expected. For example, should the accountant now be required to talk to all of his or her close and immediately family members on a daily basis regarding all of his or her clients and business relationships to ensure that he or she has identified any threats to their compliance with the fundamental principle of objectivity? Will every threat that was not proactively identified by the accountant be a breach of the requirement?

Accordingly, we do not support creating a new “shall” requirement in the conceptual framework for the accountant to identify threats to compliance with the fundamental principles. The accountant can only be required to evaluate the threats created by the facts and circumstances that the accountant knows or could reasonably be expected to know.

We also suggest that the second statement in R120.5 would be more appropriately placed in the application guidance, particularly as it is not a “shall” statement. This should not be a pre-requisite to the identification of threats and it is not feasible for the accountant to be required to understand all facts and circumstances that might compromise compliance with the fundamental principles

We agree that the categories of threats used in the extant Code remain appropriate.

Evaluating Threats

The Board proposes expanding the application material in the Code to better describe the process by which professional accountants should evaluate threats. However, as noted above, a very significant and important qualifier - the requirement to evaluate threats based on the circumstances and relationships that the accountant knows or could reasonably be expected to know - has been removed.

The Board has instead, we consider incorrectly, moved the concept of “facts and circumstances that the accountant knows or could reasonable by expected to know” into the concept of the reasonable and informed third party. The rationale for doing this is unclear.

Re-evaluating Threats

The Board is proposing a new requirement in R.120.8 that requires the accountant to “re-evaluate and address a threat” if the accountant becomes aware of “new information or changes in facts and circumstances that might impact whether a threat has been eliminated or reduced to an acceptable level.” It is not clear what this requirement is seeking to achieve. This step is already implicitly part of the conceptual framework. When a professional accountant knows, or could reasonably be expected to know, of facts or circumstances that may compromise compliance with the fundamental principles, whether because the facts and circumstances have changed or there is new information, he or she is required to evaluate those threats.

We support making the application of the conceptual framework clearer if this is an area that has led to confusion, however in such a case, the clarification should form part of the application guidance on applying the conceptual framework. Practically speaking, the application guidance in 120.8 A1 and 120.8 A2 is helpful, however it would more appropriately form part of the existing application guidance on Evaluating Threats.

Overall Assessment

There is no rationale in the Exposure Draft to explain why the Board “felt it important to include – as part of, and not distinct from, the application of the conceptual framework - a new requirement for the professional accountant to perform an overall assessment by reviewing the judgments made and overall conclusions reached.”

It is not clear what the Board’s proposal in paragraph R120.9 requires the accountant to do that is not already required to be done under the conceptual framework. It is also not clear how it is different or additional to existing obligations to determine that threats to compliance with the fundamental principles have been eliminated or reduced to an acceptable level. For example, when should this overall assessment be undertaken? Is it a periodic assessment that the professional accountant is required to document? What triggers the assessment to be undertaken? Is the assessment part of the conceptual framework or not? Neither the re-evaluation of the threats nor the overall assessment are included as steps in proposed paragraph 120.2. We strongly believe that including a requirement in the Code that is not clear in its meaning is not in the public interest.

We do consider it is a very important principle the professional accountant to take a step back and consider the overall picture and not only be focused on specific threats and safeguards in isolation. We support making the provisions clearer if this is an area that has led to confusion, and, if this is the Board’s intention with this provision, then we urge the Board to consider whether its objectives can be better achieved by making this part of the application guidance on applying the conceptual framework, not as an additional step.

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?

Reasonable and informed third party

The reasonable and informed third party is a tried and tested concept within the law and in trying to define it, we consider that the Board has changed and expanded its essential meaning. This not only creates confusion for professional accountants, it also confuses the issue of enforceability which is one of the Board’s objectives.

We agree that the “reasonable and informed third party” concept is an extremely important and fundamental concept in the Code. However, we disagree with the statement in the Exposure Draft that it is “whereby the professional accountant considers whether there has been compliance with the fundamental principles.” It is in fact whereby the accountant, after considering compliance with the fundamental principles in fact, considers compliance in appearance. It is the requirement that the professional accountant be guided not solely by the effect that the threats and safeguards would have on his or her compliance with the fundamental principles, but by the perceived effect it could be expected to have.

We do not consider it helpful to describe a reasonable and informed third party as a “hypothetical person” nor a person that has “skills and experience.” It isn’t a person of any sort, actual or hypothetical. It is a legal concept to demonstrate an objective weighing of facts by the professional accountant him or herself, using professional judgment. The Board’s proposal makes it appear that this is a separate person who evaluates the appropriateness of the professional accountant’s judgments and conclusions; when in fact it is a test that the professional accountant applies to evaluate compliance in appearance rather than fact.

The Board has also changed the reasonable and informed third party test by replacing “weighing all the specific facts and circumstances available to the professional accountant at that time” (in extant paragraph 120.4, emphasis added) with “weighing all the relevant facts and circumstances that the accountant knows or could reasonably be expected to know, at the time the evaluation is made” (in proposed paragraph 120.4 A1, emphasis added). It is not explained why this change has been made, however we consider it fundamentally changes the test.

Instead of providing a framework to assist the accountant to consider compliance in appearance on the basis of his or her professional judgment, it appears to create a mechanism for a hypothetical person to “second-guess” the assessment made by the professional accountant as to what relevant facts they could reasonably have been expected to know, not the specific facts available on which the accountant is making the assessment.

We urge the Board to reconsider its proposals with respect to trying to define a reasonable and informed third party.

Revised definition of acceptable level

We do not object to including the definition of “acceptable level” (currently in the Glossary of the extant Code) in the main body of the Code to give this term prominence. We continue to have the same concerns, as expressed previously, regarding the interaction of the changes to this provision with the changes to the definition of a reasonable and informed third party and the other changes to the conceptual framework as a whole, including the removal of “weighing all the specific facts and circumstances available to the professional accountant at that time.” As noted above with respect to the reasonable and informed third party test, it is important that any conclusion on whether a threat is at an acceptable level is reached solely on the facts and circumstance available to the accountant at the time of the evaluation and based on the accountant using their professional judgment.

We are additionally concerned with the removal of very important guidance contained in extant paragraph 100.9 that there may be situations where threats cannot be eliminated or reduced to an acceptable level, either because the threat is too significant or because appropriate safeguards are not available or cannot be applied. In such situations, the extant Code specifically states that the professional accountant shall decline or discontinue the specific professional activity or service involved or, when necessary, resign from the engagement or the employing organization. We consider it is weakening the application of the conceptual framework to suggest in proposed paragraph 120.7 A1 that instances where threats that are so significant that no safeguards could reduce the threat to an acceptable level could only arise in the context of the independence standards. Likewise, we consider it confusing to not have any linkage now between the concept of threats that are too significant that they cannot be reduced to an acceptable level (proposed paragraph 120.7 A1) and declining or discontinuing the activity or service (proposed paragraph R120.7(c)).

3. Do respondents support the proposed description of “safeguards”?

We support the Board’s objective of clarifying the application of safeguards, however we do not understand how the objectives being sought by the Board are achieved by defining a safeguard as an action that must be “effective” in order to eliminate or reduce threats to compliance with the fundamental principles. The safeguards are actions taken to address threats, but the effectiveness of such actions would seem to be a separate assessment. Much in the same way that a mitigating action or control is implemented in response to a weakness or a risk, the effectiveness of the action must be judged at the time it is applied by the accountant, both in fact and appearance, and then

potentially re-evaluated if circumstances change. We suggest the description of safeguards in proposed paragraph 120.7 A2 be amended as follows: “Safeguards are actions, individually or in combination that the professional accountant takes ~~that effectively~~ to eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.”

The Board considers that the proposed description of safeguards, together with the other proposed clarifications to the conceptual framework establish a stronger correlation between “threats and safeguards” and the fundamental principles in the Code. Yet, if safeguards are by their nature effective, individually or in combination, it is unclear why the Board believes it is necessary to add steps to re-evaluate threats when existing threats have already been reduced or eliminated through safeguards (which by definition must be effective in doing so), unless there has been a change in circumstances.

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 one applies the proposed definition of a safeguard to these safeguards in the extant Code, then it may be reasonable to conclude that they no longer meet the definition of a safeguard. This is a result of the changes being proposed which appear to refocus the conceptual framework into a series of activities that must be performed by the professional accountant rather than the application of a holistic framework (which includes safeguards in the profession, work environment etc.) designed to help the professional accountant comply with the fundamental principles.

Nonetheless, changing how the Code refers to these safeguards (for example as conditions, policies and procedures) should not change their importance to the conceptual framework. Whether or not they are referred to as safeguards or whether they are considered to duplicate existing requirements imposed by quality controls, without the “safeguards created by the profession or legislation,” and “safeguards in the work environment,” the safeguards applied at an individual level by the professional accountant cannot be effective on their own.

By making this distinction in proposed Section 120, the “conditions, policies and procedures” have been demoted as being only relevant to the likelihood of a professional accountant identifying a threat to compliance to the fundamental principles (the activity being undertaken by the accountant) rather than also being important in helping the professional accountant comply with the fundamental principles. For example, they also act as deterrent to unethical behavior, as referred to in extant 100.16, which refers to an “effective, well publicized complaint system operated by the employing organization... that enables colleagues, employers and members of the public to draw attention to unprofessional or unethical behavior”. The proposals have simply included an “effective complaint system” as an example of a condition in 120.5 A4 and it is unclear what this means without the context in the extant Code.

We have the same comments with respect to the classification of “conditions” that might impact the evaluation of whether a threat is at an acceptable level in Section 300. Given the importance of the “safeguards created by the profession or legislation,” “safeguards in the work environment,” and

“conditions, policies and procedures”, the Board should consider re-locating these concepts to the introductory section of the conceptual framework or a place of similar prominence.

The International Forum of Independent Audit Regulators (“IFIAR”) in its “2015 Inspection Findings Survey” released on March 3, 2016 links its inspection findings with respect to independence and ethical requirements with International Standard on Quality Control 1, “Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements” (“ISQC1”). In IFIAR’s report, a departure from standards on quality control and ethics and independence requirements may or do have an effect on audit quality. We do not believe that the Board can isolate the conceptual framework and the application of safeguards from their inherent reliance on a system of quality controls for their effectiveness.

We suggest that before concluding on this piece of work, the Board work closer with the International Auditing and Assurance Standards Board (“IAASB”) as it undertakes its project on ISQC1 (included in the 2015-2016 IAASB work plan) to ensure there is clarity on the inter-dependence between the effectiveness of safeguards and quality controls. The Board should also consider the interaction of safeguards with requirements in International Standard on Auditing (“ISA”) 220, “Quality Control for an Audit of Financial Statements” and ISA 230, “Audit Documentation.”

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 Exposure Draft proposes setting out a requirement upfront in Section 300 that requires the professional accountant to comply with each of the fundamental principles and apply the conceptual framework set out in proposed Section 120 (paragraph R300.2). However, without the requirements set out in section 300, the application guidance seems lost. Readers may not go back to section 120 to read the requirements then back to section 300 to read the application guidance, as it is not clear to which requirement each section of application guidance corresponds. Whilst hesitant to suggest more repetition of the requirement to apply the conceptual framework, in this case we support repeating the requirements from Section 120 in Section 300.

Streamlined Examples of Threats and Safeguards

The Board has “streamlined and thereby clarified the examples of the types of threats that are included in the extant Code” (paragraph 300.2 A1). We support the principle of making the examples easier to read, however are disappointed to see that many helpful and important examples of threats included the extant Code have been removed. We consider that examples are helpful, even if numerous, and removing them from the extant Code suggests that they no longer have valid application. For example, a firm entering into a contingent fee arrangement relating to an assurance engagement has been removed as an example of a self-interest threat, which suggests a change in position by the Board. As a matter of fact, such a fee arrangement creates a self-interest threat for non-assurance services as well, so rather than eliminating this example we suggest expanding it further.

The Board has also expanded the application of other examples of threats through rewording, or through the use of “professional accountant” and “firm”, instead of “member of the assurance team”. In some cases “professional accountant” is used when “firm” or “member of the assurance team” would be more appropriate considering these are safeguards in Section 300.

For instance, the first example of a self-interest threat under 300.2 A1(a) refers to a professional accountant having a direct financial interest in any client; whereas the extant code refers to a member of the assurance team having a direct financial interest in an assurance client. This example is much more restrictive than what is in the extant Code and when taken in conjunction with the other changes in the Code will raise doubt as to its interpretation. If any professional accountant having a financial interest in any client could create a self-interest threat, then it is unclear to what lengths a professional accountant must go to satisfy the new requirement that they “shall identify” threats.

In section 300.2 A2: The Board is proposing to clarify that some safeguards in the extant Code are in fact conditions that might impact the professional accountant’s evaluation of whether a threat is at an acceptable level, and streamline the examples. Those conditions include:

The nature of the client and its operating environment: This section is confusing as the examples used in 300.2 A3 are actually about the professional services being provided by the firm, not about the client and its operating environment (unlike 300.32 A4). Also, we do not consider the Board is correct in stating that providing a service to an audit client might be perceived to result in a higher level of threat to the fundamental principles. In fact the threat remains the same regardless of whether the same service is provided to an audit client or not; what changes is whether the threat is considered to be at an acceptable level depending on whether or not a client is an audit client. The same holds true whether or not an audit client is a public interest entity. This will impact the perceived acceptable level of threat, not the level of the threat itself.

The professional service being provided: This should include much of the discussion in 300.2 A3 which addresses the provision of professional services such as audit services.

Examples of Safeguards

We support retaining the examples of engagement specific safeguards in 300.2 A9 that are in the extant Code, including the type of threat that is being addressed. However the wording of some of the examples could be improved. In the first two bullet points it is unclear what is meant by “or otherwise advise as necessary”. In the fourth bullet point, it is unclear why consulting with those charged with governance would address an advocacy threat.

Re-evaluating threats

Paragraph 300.2 A11 provides that actions implemented as safeguards may no longer be effective in eliminating threats or reducing them to an acceptable level, however does not explain what should be done about it. As mentioned previously, it seems to weaken the conceptual framework to separate any discussion about acceptable level from the concept that threats created may be too significant that no safeguards may be applied. The paragraph should at least direct the professional accountant towards what next steps could be taken; for example applying additional safeguards, declining to provide the service or discontinuing an existing relationship as soon as practicable.

Enhancing Consistency in the Terminology Used in the Code

We are supportive of the Board’s intention to ensure terms are used in a consistent manner in the Code. We note that the Board does not believe that the use of “significant” is appropriate to be used in the conceptual framework. As noted previously, we consider that removing the concept of “threats that are so significant that no safeguards can be applied” weakens the application of the conceptual

framework. It is unclear why the Board has concluded that the term may only be relevant in the context of threats and safeguards relating to non-audit services provided to an audit client.

Drafting comments:

We suggest the following edits to enhance the readability of the proposed standards:

120.5A2 Threats to compliance with the fundamental principles fall into one or more of the following categories: ...

(b) Self-review threat – the threat that a professional accountant will not appropriately evaluate:

- the results of a previous judgment made, or
- activity or service performed

by the accountant, or by another individual within the accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity or providing a current service;

R120.6 When the professional accountant identifies a threat to compliance with the fundamental principles, the accountant shall evaluate whether such a threat is at an acceptable level.

120.6 A2 The ~~existence~~ consideration of qualitative as well as quantitative factors is relevant to the professional accountant's evaluation of threats, as is the combined effect of multiple threats, if applicable.

R120.7 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating or reducing them to an acceptable level. The accountant shall do so by:

- Eliminating the circumstances, including interests or relationships, that are creating the threats;
- Applying safeguards, where available and capable of being applied; or
- Declining or discontinuing the specific professional activity or service involved or resigning from the engagement (in the case of a professional accountant in public practice) or the employing organization (in the case of a professional accountant in business)

Paragraph 120.7 A2 seems to more logically come before 120.7 A1.

300.2 A2 Conditions that might impact the evaluation of whether a threat to compliance with the fundamental principles is at an acceptable level include the nature of:...

300.2 A7 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, Section 120 requires that the accountant address those threats by:...

300.2 A9 Safeguards vary depending on the facts and circumstances. The following are examples of actions that in certain circumstances might be safeguards in addressing threats:

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- Having a professional accountant who was not a member of the team review the work performed or otherwise advise as necessary might address a self-review threats.

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We would be pleased to discuss our comments with members of the IESBA or its staff. If you wish to do so, please feel free to contact Wally Gregory, Managing Director Global Independence, via email (wgregory@deloitte.com) or at +1 203 761 3190.

Sincerely,

A handwritten signature in cursive script that reads "Deloitte Touche Tohmatsu Limited".

Deloitte Touche Tohmatsu Limited