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Submitted electronically to [kensiong@ethicsboard.org](mailto:kensiong@ethicsboard.org)

Mr K Siong  
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International Ethics Standards Board for Accountants (IESBA)  
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Dear Ken

**Comments on the Exposure Draft on the Proposed Revisions Pertaining to Safeguards in the Code – Phase 1**

The Independent Regulatory Board for Auditors (IRBA) is the audit regulator and national auditing and ethics standard-setter in South Africa. Its statutory Committee for Auditor Ethics (CFAE) is responsible for prescribing standards of professional competence, ethics and conduct for registered auditors. One of the IRBA's statutory objectives is to protect the public by regulating audits performed by registered auditors, thereby promoting investment and employment in South Africa. In preparing this comment letter, the IRBA through its CFAE hosted a seminar among users and practitioners to consider the exposure draft and has also drawn on feedback from the seminar in drafting these comments.

The IRBA adopted Parts A and B of the International Ethics Standards Board for Accountants' (IESBA) *Code of Ethics for Professional Accountants* (the Code). This was prescribed in 2010 as the *Code of Professional Conduct for Registered Auditors* (the IRBA Code) in South Africa, with certain additional national requirements. The IRBA Code, with its *Rules Regarding Improper Conduct*, provides the basis for disciplinary action against registered auditors. As the IESBA's exposure draft on the proposed revisions pertaining to safeguards in the IESBA Code could result in possible amendments to Parts A and B, the IRBA has particular interest in the process.

We appreciate this opportunity to comment on the exposure draft and our comments are presented under the following sections:

- A. General Comments;
- B. Request for Specific Comments and Responses;
- C. Request for General Comments; and
- D. Annexure A: Suggestions regarding Proposed Amendments.

If you have any questions or would like to discuss any specific comments, please contact:

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Yours faithfully

**Signed electronically**

**Imran Vanker**  
**Director: Standards**

**Saadiya Adam**  
**Professional Manager: Ethics**

## A. General Comments

- 1.1. The IRBA supports the initiatives of the IESBA to improve clarity and eliminate inappropriate use of safeguards, thereby facilitating their adoption, effective implementation and consistent application.
- 1.2. As a regulator of registered auditors, we are concerned about the enforceability of the Code. Likewise, we support initiatives that create an enabling environment for registered auditors to apply the Code. We believe that the Code is imperative in protecting the public interest and we thus support initiatives that promote ease in understanding the Code.
- 1.3. While the exposure draft on the IESBA Code of Ethics for Professional Accountants has been drafted in the context of professional accountants, our responses are provided in the context of registered auditors who perform audits and reviews and also provide other assurance services.
- 1.4. We note that the Board plans to continue considering 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) – see page 7, paragraph 7. We encourage the Board to consider this as part of this phase of the project as this is an important aspect that is not addressed in the extant Code. We are confused by the Board decision to address the general need for safeguards without addressing the higher risk prevalent in PIEs.
- 1.5. While we understand that this project has been completed in parallel with the IESBA Re-Structure Project, reference is made to both the Code and the Standard in this exposure draft. Please reconsider these references as they will create confusion in the future.
- 1.6. In light of the Restructured Code and the multiple references to the conceptual framework, especially in the requirements, we stress that sufficient clarity is required in the proposed amendments to safeguards to allow the IESBA Code to be robust and enforceable.
- 1.7. There are certain words or phrases in this exposure draft that are unclear and need to be reconsidered, e.g. “so significant”, “deters”, “encourages”, “otherwise advise”, “many variations” and “recently”. The use of such words/phrases would make uniform application impossible, and create the likelihood of unsuccessful enforceability. In light of the Board’s commitment to clarity, we ask it to reconsider such words/phrases.
- 1.8. We remind the Board of the recent IESBA exposure draft relating to non-compliance with laws and regulations (NoCLAR), which mentions “safeguards”. It appears that certain wording proposed previously will now be inconsistent with the definition proposed in the safeguards exposure draft.

An example of this is the following extract from the NoCLAR Exposure Draft issued on 6 May 2015. The example provided below does not meet the proposed definition of a safeguard.

*“210.7 A professional accountant in public practice shall evaluate the significance of threats and apply safeguards, when necessary, to eliminate them or reduce them to an acceptable level. Examples of such safeguards include:*

- *Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.”*

- 1.9. Words such as “safeguards” and wording similar to the extant IESBA Code of Ethics are used and applied in various IAASB International Standards on Auditing (ISAs)<sup>1</sup>. We would like to bring to your attention an example from the ISAs that is inconsistent with these proposed amendments to the definition of safeguards and will need to be reconsidered:

*In ISA 260: “A22(b) Safeguards created by the Profession, legislation or regulation, safeguards within the entity and safeguards with the firm’s own system and procedure.”*

## **B. Request for Specific Comments and Responses**

### **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?*

- 1.1. No. As the conceptual framework is the foundation for the use of the IESBA Code, we feel that the proposed amendments are insufficient to bring the required clarity and allow for enforceability in the future.
- 1.2. The conceptual framework has not been given the prominence it deserves. The repetition of the header on each page of the proposed restructured IESBA Code is not sufficient for a better understanding of the Code.
- 1.3. We suggest that consistent reference be made to a five-step Conceptual Framework, which entails the following:
- 1.3.1. Identify threats;
  - 1.3.2. Evaluate threats;
  - 1.3.3. Address threats;
  - 1.3.4. Re-evaluate threats; and
  - 1.3.5. The overall assessment.

We note that para 120.2 only makes reference to the first three steps, which may lead users to question whether there has been any change from the extant approach.

- 1.4. A requirement to document the professional accountant’s evaluation of the conceptual framework would allow for enforceability. It would be difficult to assess post facto if this step was properly considered without the professional accountant’s documented understanding.

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<sup>1</sup> ISQC1, ISA 200, ISA 220, ISA 240, ISA 260, ISA 315(R), ISA 402, ISA 500, ISA 501, ISA 610, ISA 620, ISA 620

1.5. Also, a diagrammatic representation will help users understand this process better, and assist in identification and recollection of the conceptual framework.

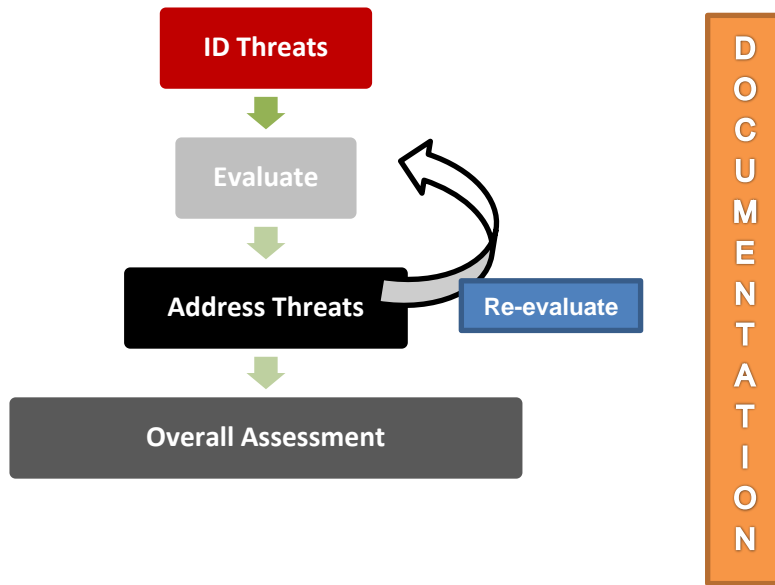


Diagram 1: Suggested Diagrammatic Representation to the Five-Step Conceptual Framework

1.6. We have observed that in the five-step Conceptual Framework outlined above there has been an inadvertent omission that is imperative to understanding the conceptual framework. This omission relates to “designing and implementing a safeguard”. This step can be performed after either the “evaluate the threats” or “address threats” steps.

1.7. Below are more detailed notes on items the Board should consider in finalising the proposed amendments.

**(a) Identifying Threats**

1.8. The current proposed amendments do not make it clear that there is a rebuttable presumption that every engagement or situation will have some threat. This is similar to the language used in the ISAs when considering risk assessment, as discussed in ISA 220 and ISA 315. As such, we suggest that this be rephrased so it reads as follows: *A professional accountant shall presume that there is a threat to the fundamental principles in every engagement or situation. When identifying and assessing the threats to the fundamental principles, the professional accountant will have to document where he or she concludes that the presumption is not applicable in the circumstances of the engagement and, accordingly, has not identified threats to the fundamental principles*

1.9. Threats may arise in categories not described in the five threats provided in para 120.5 A2. We also note that these threats are limited to objectivity and independence. We suggest that there may be threats to other fundamental principles.

1.10. Though not specifically stated, there is general understanding of when threats are considered at an engagement level. We agree that identification of threats should not be limited to the engagement level but rather that there is also a responsibility to consider threats at a firm level. However, it is unclear what would trigger the firm to identify threats to the fundamental principles.

**(b) Evaluating Threats**

1.11. We suggest that the first option for a professional accountant would be to eliminate the threats identified. If it is not possible to eliminate the threat, only then should the option to reduce the threat to an acceptable level be available.

1.12. Requirement R120.6 is inconsistent with R120.7 as proposed under addressing threats. We would like to change the tone of this requirement and suggest that a professional accountant should try to address the specific threat rather than allow for a classification of such a threat as acceptable without any effort to eliminate it.

1.13. Para 120.6 A3 requires further consideration. While we agree that there may be circumstances that mitigate the impact of the threat, the way this is phrased suggests that a professional accountant may evaluate the threat with the policies and procedures identified under para 120.5 A4 and will not be required to take any further action.

**New Step – Designing and Implementing a Safeguard**

1.14. This subsection will consider the correlation between the specific threat that has been identified and the safeguard response.

1.15. We suggest that the illustration of the five- Step Conceptual Framework be updated as below:

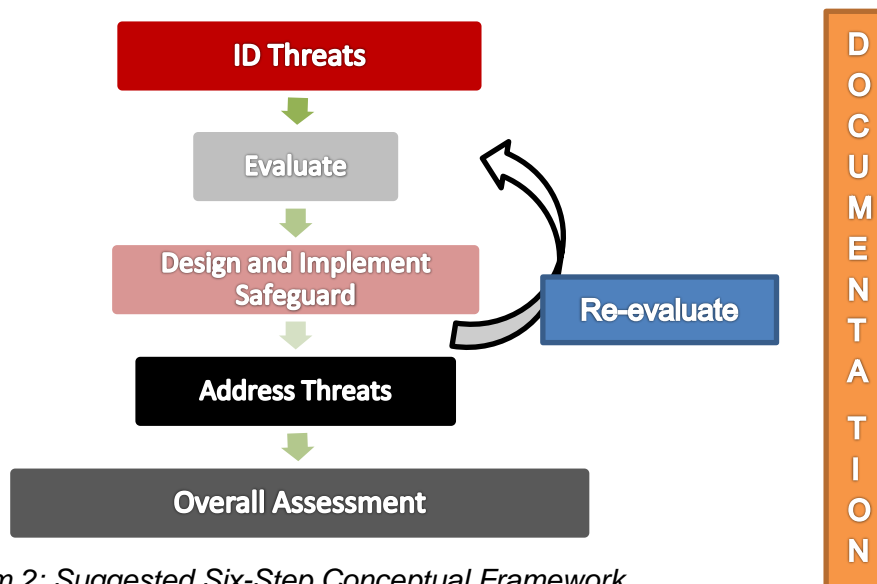


Diagram 2: Suggested Six-Step Conceptual Framework

- 1.16. We suggest that the definition of a safeguard be moved to the section that deals with application material on elements of a safeguard. We discuss this further below.
- 1.17. In the explanatory memorandum, pg. 7, point 9(f) states that actions are only safeguards when they are effective in eliminating threats to compliance with the fundamental principles or reducing them to an acceptable level. However, a similar emphasis is not made in the proposed amendments. Therefore, the amendments should be updated to reflect this critical element.

### **(c) Addressing Threats**

- 1.18. The proposed amendment does not suggest how quickly a professional accountant would have to address the threat. We suggest that if a threat is not addressed in a timely manner, this may lead to a breach in the requirement of the Code. The Code should address this shortcoming with a requirement.

### **(d) Re-evaluating Threats**

- 1.19. Para 120.8 suggests that this step will be done when the professional accountant becomes aware of new information or changes in facts and circumstances. There is no requirement to do this exercise regularly or at least on an annual basis.
- 1.20. If there are threats at an engagement specific level, there should be a requirement to perform this step towards the end of the engagement, even if no new information has come to the professional accountant's attention.
- 1.21. Although this is a requirement in ISA 220, it is necessary to include it in the Code because this step should be required on all engagements and not be limited to audit engagements.

### **(e) The Overall Assessment**

- 1.22. From the explanatory memorandum, we understand this step to be the "stepping back" principle. However, as these words have not been included in the proposed amendments, we would suggest their inclusion to bring clarity.
- 1.23. The proposed amendment does not include reference to the timing of this step, i.e. when the professional accountant will be required to carry out this step.

### **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?*
- 2.1. Through our consultation with a range of stakeholders and review, we found that the reasonable and informed third party test was still a cause for confusion.
- 2.2. One reason for this confusion is that the name is similar to the term "reasonable man test", which is used in the legal profession. These are considered different as the concept in the Code suggests that the person has a certain level of skills, knowledge and experience, which is different to the test used in the legal profession. Also, the

definition in the Code is a self-imposing test, while tests similar in concept are performed by a third party. We suggest that a change in the phrase may help to make it clear that these two concepts are different.

- 2.3. Additional clarity needs to be given that this is not an actual person, but rather a test or concept.
- 2.4. We suggest that the word “hypothetical” does not enhance clarity and should be reconsidered.
- 2.5. The definition of a reasonable and informed third party has certain commonality with the definition of professional judgement. We noted that professional judgement, though used in the Code, is not defined. The ISAs, however, include a definition of professional judgement which can be considered.
- 2.6. The revision should make it clear that the professional accountant will be performing the test.
- 2.7. Although it can be inferred that the reasonable and informed third party could be highly skilled and experienced, it is unclear from the text what level of skills, knowledge and experience is expected. Would this imaginary person be at a beginner level, an expert level or have working knowledge?
- 2.8. We believe that the reasonable and informed third party would not be limited to a professional accountant. However, the description of this test is not clear.
- 2.9. It is unclear what the expectation would be on the professional accountant when making these decisions. Would it be inherent or implied, or would the professional accountant be required to document this concept?
- 2.10. We question whether the bar has been set too high with this description. Not all investors will meet this definition, yet they will be able to judge a professional accountant based on appearance. There may be some inconsistency created.
- 2.11. We emphasise that the reasonable and informed third party concept be included in the description of independence of appearance. Thus, the way the definition is finalised will affect the way the independence in appearance principle is understood and used in the future.
- 2.12. “Acceptable Level”: This definition seems to get lost in the proposed amendment. Its prominence should be improved.
- 2.13. There are many variable in this definition, which may suggest that this concept will be difficult to use, especially from an enforceability perspective. We suggest that the word “likely” be removed from the definition.

### **Proposed Revised Description of Safeguards**

3. *Do respondents support the proposed description of “safeguards”? If not, why not?*
  - 3.1. We suggest that the definition of safeguards be followed by application material. Additional elements of the description of a safeguard that the Board may want to consider, inter alia, are the following:
    - 3.1.1. Can be disclosed;
    - 3.1.2. Can be corroborated;
    - 3.1.3. Can be reproduced;
    - 3.1.4. Must be commensurate with the threats;
    - 3.1.5. Must not itself further threaten independence or the public interest;

- 3.1.6. Is not the first resort;
  - 3.1.7. Must not be subjective (its utility, must be self-evident); and
  - 3.1.8. Can be documented.
- 3.2. Para 120.5 A4 should not reduce the primary duty of the professional accountant to identify threats and clarify that the list is not a safeguard.
  - 3.3. Safeguards can be enhanced by including application material that can address correlation between the safeguards and threats as well as the proportionality of safeguards considered.
  - 3.4. The safeguards definition has only identified the professional accountant. We question whether the firm has been inadvertently left out of the definition.
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?*
- 4.1. Yes.
  - (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?"*
  - 4.2. Yes.  
*If not, why not?*
  - 4.3. We suggest that transitional provisions be provided for policies and procedures that have been used as safeguards as described in the extant Code. This is a reminder that where these have been applied as safeguards, they should be rescinded and threats reconsidered.

#### **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?*
- 5.1. We are disappointed to note that there is only one requirement proposed under Section 300. The proposed amendments do not adequately capture why the professional accountant in public practice is so important that this warrants specific application material.
  - 5.2. We suggest that Section 300 should repeat the requirement in Section 120, but in the context of a professional accountant in public practice.
  - 5.3. There is room for improvement in the examples provided to highlight multiple threats, the interplay between the threats and their impact on the assessment to an acceptable level.
  - 5.4. Para 300.2 A4 and Para 300.2 A6 do not stress sufficiently that those are not examples of safeguards. We suggest that the number of examples be reduced or deleted.



- 5.5. The examples of safeguards in 300.2 A9 might be improved by demonstrating how they would be effective in reducing threats.
- 5.6. In finalising this amendment, we suggest that the Board considers whether there should be a requirement to disclose safeguards to those charged with governance. It may also be necessary to build into ISQC1 a requirement to review and/or disclose safeguards under the EQCR engagement review.

### **C. Request for General Comments**

6. *(a) Small and Medium Practices (SMPs) – the IESBA invites comments regarding the impact of the proposed changes for SMPs.*
- 6.1. The lack of clarity on some important concepts in the proposed amendments would make it especially difficult for SMPs as additional time and resources would be required for them to comply with the conceptual framework.
7. *(b) Developing Nations – Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.*
- 7.1. In environments of relatively recent adoption of the ISAs and the Code, the need for clarity is self-evident. The limited experience of practitioners, standard-setters and regulators with application of the Code, makes structure and enforceability of the Code paramount. With this in mind, we believe that emphasising the “elements of a safeguard”, as well as spelling out a “Six Step Conceptual Framework” would be very helpful.
8. *(c) Translations – Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comments on potential translation issues respondents may note in reviewing the proposals.*
- 8.1. We are highlighted throughout this letter, the terminology that is problematic to apply and will thus also pose difficulties in translation.

## **Annexure A**

In this Annexure, we have made suggestions for possible edits in line with some of our comments to the specific questions. This is not a comprehensive proposal of all edits, which should include more requirements.

### **Suggestions regarding Proposed Amendments**

#### **The Conceptual Framework**

##### **Introduction**

120.1 The circumstances in which professional accountants operate ~~might~~ create specific and general threats to compliance with the fundamental principles. However, ~~the~~ conceptual framework can assist the accountant in complying with the fundamental principles and meeting the responsibility to act in the public interest. It also accommodates the range many variations, in of facts and circumstances that create threats to compliance with the fundamental principles of integrity, confidentiality, objectivity, professional behaviour and due care, and professional competence. In addition, it and deters prohibits an accountant from concluding that a situation is permitted if it is not specifically prohibited by this Code.

120.2 The conceptual framework specifies the following an approach for the professional accountant ~~to~~:

- (a) Identify threats to compliance with the fundamental principles;
- (b) Evaluate the threats identified; ~~and~~
- (c) Design and implement safeguards to address the threats by eliminating or reducing them to an acceptable level;
- (d) Re-evaluate the threats; and
- (e) Overall assessment.

##### **Requirements (R) and Application Material (A)**

**R120.3** The professional accountant shall apply the conceptual framework, which involves identifying, evaluating, ~~and~~ designing and implementing safeguards, to addressing threats to compliance with the fundamental principles, re-evaluate the threats and make an overall assessment of threats.

**R120.4** When applying the conceptual framework, the professional accountant shall:

- (a) Act in the public interest;
- (b) Exercise professional judgement;
- (c) Remain alert to changing circumstances; and
- (d) Take into account whether a reasonable and informed third party would likely conclude that the accountant has complied with the fundamental principles.

##### **Reasonable and Informed Third Party Concept and Test**

(We propose a new name for this test – one that would distinguish it from the legal test that is currently available.)

120.4 A1 The concept of a reasonable and informed third party is a test ~~that~~which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant's firm's judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant/firm knows, or could reasonably be expected to know, at the time that the evaluation is made, to determine whether the accountant complies with the fundamental principles when acting in the public interest.

120.4 A2 (Include information that explains how to use the reasonable and informed third party test.)

### Identifying Threats

R120.5 The professional accountant shall identify threats to compliance with the fundamental principles. An understanding of the facts and circumstances, including professional activities, interests and relationships, firm circumstances and external factors that might compromise compliance with the fundamental principles, is a prerequisite to the accountant's identification of threats to such compliance.

120.4 A1 Threats might be created by a range of facts and circumstances. It is ~~impossible unlikely that to define~~ every situation that creates threats will be defined. In addition, the nature of engagements and work assignments might differ and, consequently, different types of threats might be created. It should be noted that all assignments with regard to facts and circumstances present threats.

120.4A2 Threats to compliance with the fundamental principles fall into one or more of the following categories, which are not by any means exhaustive:

- Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behaviour.
- 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.
- Advocacy threat – the threat that a professional accountant will promote a client's or employer's position to the point that the accountant's objectivity is compromised.
- Familiarity threat – the threat that due to a long or close relationship with a client or employer a professional accountant will be too sympathetic to their interests or too accepting of their work. ~~and~~
- Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

120.5 A3 A circumstance might create more than one threat, and a threat might affect compliance with more than one fundamental principle.

120.5A4 Certain conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization can affect the likelihood of the accountant's identification of threats to compliance with the fundamental principles. Examples of such conditions, policies and procedures include:

- Corporate governance requirements.
- Educational, training and experience requirements for the profession.
- Effective complaint systems.
- An explicitly stated duty to report breaches of ethical requirements.
- Professional or regulatory monitoring and disciplinary procedures.

The existence of the above conditions, policies and procedures does not reduce the professional accountant's primary duty to identify threats.

### Evaluating Threats

**R120.6** When the professional accountant identifies a threat, the accountant shall consider actions to eliminate the threat or evaluate whether such a threat ~~is~~ can be reduced to ~~at~~ an acceptable level.

120.6A1 An acceptable level is a level at which a reasonable and informed third party ~~would likely shall~~ conclude that the professional accountant complies~~d~~ with the fundamental principles.

120.6 A2 The existence 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.

120.6 A3 The existence of conditions, policies and procedures discussed in paragraph 120.5 A4 above might impact the professional accountant's evaluation of threats to compliance with the fundamental principles.

### Designing and Implementing Safeguards

#### *Safeguards*

120.7A2 Safeguards are actions, individually or in combination, that the professional accountant or firm takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.

(Include application material on characteristics of a safeguard, correlation between threats, safeguards and acceptable level.)

### Addressing Threats

**R120.7** If the professional accountant or firm 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:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied; or
- (c) Declining or discontinuing the specific professional activity or service involved.

120.7A1 There are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level, and a professional accountant shall have no other option but to decline or discontinue the engagement. International Independence Standards C1 and C2 of the Code provide examples of such situations. (Consider re-writing as a requirement.)

### ~~Safeguards~~

~~120.7 A2 Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.~~

### Re-evaluating Threats

**R120.8** If the professional 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, the accountant shall re-evaluate and address that threat accordingly.

120.8 A1 Remaining alert throughout the professional activity or service assists the professional accountant in determining whether new information has emerged or changes in facts and circumstances have occurred that could:

- (a) Impact the level of a threat;
- (b) Result in a revised determination of the acceptable level of the threat; or
- (c) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate ~~into~~ addressing identified threats.

120.8 A2 If the professional accountant identifies a new threat, the application of the conceptual framework requires that the accountant shall evaluate and address this new threat as set out in paragraphs R120.5–R120.8 above. (Make a requirement)

### Overall Assessment

**R120.9** The professional accountant shall “step back” and review judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated or reduced to an acceptable level, and that no further action is needed. The reasonable and informed third party test described in paragraph 120.4 A1 is required in addition ~~is relevant~~ to this

assessment. The professional accountant shall communicate with those charged with governance regarding the overall assessment of the engagement.

120.9 A1 This step should be performed at least when a threat has been evaluated or re-evaluated.

R120.10 The professional accountant shall document the evaluation of the overall assessment. An overall assessment is required whenever a new threat is identified, a re-evaluation is done or new information that would affect the professional accountant's assessment is available.

## C. SECTION 300: PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

### Section 300

#### Application of the Conceptual Framework Approach by Professional Accountants in Public Practice

##### Introduction

300.1 This part of the Code ~~describes considerations~~ specifies application considerations of the conceptual framework for professional accountants in public practice ~~in the application of the conceptual framework as~~ set out in Section 120. ~~It This Part~~ does not describe all ~~of~~ the facts and circumstances, including professional services, interests and relationships that could be encountered by accountants,<sup>2</sup> ~~that~~which create or might create threats to compliance with the fundamental principles. Therefore, accountants ~~are encouraged~~ have a responsibility to be alert for such facts and circumstances.

300.2 (Consider adding a paragraph on PA in PP, public interest and independence.)

##### Requirements and Application Material

**R300.2** A professional accountant shall comply with each of the fundamental principles of integrity, confidentiality, objectivity, professional behaviour and due care, and professional competence and apply the conceptual framework set out in Section 120 to eliminate threats to compliance with those fundamental principles or to reduce them to an acceptable level.

##### Identifying Threats

300.3A1 Compliance with the fundamental principles ~~is~~ might be threatened by a ~~broad~~ range of facts and circumstances. The following are categories of threats and examples of facts and circumstances that ~~might~~ often create those threats for a professional accountant when undertaking a professional activity or providing a professional service:

- (a) Self-Interest Threats

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<sup>2</sup> In Part C and in C1 and C2, the term "professional accountant" refers to professional accountants in public practice and firms of professional accountants in practice.

- A professional accountant or firm having a direct financial interest in a client.
  - A professional accountant or firm having undue dependence on total fees from a client or the possibility of losing a significant client.
  - A professional accountant or firm having a significant close business relationship with a client.
- (b) Self-Review Threats
- A professional accountant or firm issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
  - A professional accountant having prepared ~~the~~ all or some of the original data used to generate records that are the subject matter of the assurance engagement.
  - A professional accountant being, or having recently been, a director or officer of the client, or having recently been employed by the client in a position to exert significant influence over the subject matter. matter of the engagement.
- (c) Advocacy Threats
- The professional accountant or firm promoting the interest of the client, or shares in a client or related venture.
  - A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.
- (d) Familiarity Threats
- A member of the engagement team having a close or immediate family member who is a director or officer of the client, or is an employee of the client and who is in a position to exert significant undue influence over the subject matter of the engagement.
  - A director or officer of the client, or an employee in a position to exert significant undue influence over the subject matter of the engagement, having recently served as the engagement partner.
  - Senior personnel or firm having a long close association with the assurance client.
- (e) Intimidation Threats
- A professional accountant or firm being threatened with dismissal from a client engagement.
  - A professional accountant or firm feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
  - A professional accountant or firm feeling pressured to agree with the judgment of a client employee because of political influence.
  - A professional accountant being informed by a partner of the his or her employer or firm that a planned promotion will not occur unless the accountant agrees with an audit client's inappropriate

accounting treatment.

The categories of threats are also discussed in Section 120.

### **Evaluating Threats**

300.2 A2 Conditions that might impact the evaluation of whether a threat is at an acceptable level include the nature of:

- (a) The client and its operating environment;
- (b) The professional service being provided; and
- (c) The firm and its operating environment.

#### *The Client and its Operating Environment*

300.2 A3 The level of a threat might be impacted by the following types of client or professional service that is provided:

- (a) An audit client and whether the audit client is a public interest entity;
- (b) An assurance client that is not an audit client; or
- (c) A non-assurance client.

For example, providing a service to an audit client might be perceived to result in a higher level of threat to the fundamental principle of objectivity. Such a threat might be further increased when the audit client is a public interest entity with a large number and a wide range of stakeholders.

300.2 A4 A professional accountant's evaluation of the level of the threat might also be impacted by a client's operating environment. For example:

- The client requires appropriate persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that facilitate objective choices in tendering non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

#### *The Professional Service Being Provided*

300.2 A5 The level of a threat is impacted by the nature and scope of the professional service. Examples of professional services, the threats that might arise as a result and how a professional accountant may address those threats are discussed in International Independence Standards C1 and C2.

#### *The Firm and its Operating Environment*

300.2 A6 A professional accountant's evaluation of the level of a threat might be impacted by the work environment within a firm and its operating environment. For example:

- Leadership of the firm that promotes compliance with the fundamental



principles and establishes the expectation that professional accountants will act in the public interest.

- Methods and processes for establishing and monitoring compliance with the fundamental principles by all personnel.
- Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.
- Management of the reliance on revenue received from a single client.
- The engagement partner having authority for compliance with the fundamental principles, including decisions about the permissibility of services to an audit client.
- Educational, training and experience requirements.
- Processes to facilitate and address internal and external complaints.

### Addressing Threats

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

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied; or
- (c) Declining or discontinuing the specific professional activity or service involved.

300.2 A8 There are some situations where the threat created would be so significant that no safeguards could reduce ~~it~~~~the threat~~ to an acceptable level, and the threats may not be addressed by applying the requirements in Section 120. International Independence Standards C1 and C2 provide examples of such situations. (Consider re-writing as a requirement.)

### Examples of Safeguards

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:

- Having a professional accountant who was not involved with the non-assurance service provided to an audit client review the non-assurance work performed, or ~~otherwise~~ having them advise as necessary might address a self-review threat.
- Having a professional accountant who was not a member of the team review the work performed or ~~otherwise~~ advise as necessary might address self-review threats.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review and familiarity threats.

- Consulting those charged with governance or an independent third party, including a committee of independent directors, a professional regulatory body or another professional accountant, might address advocacy or intimidation threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy or familiarity threats.
- Rotating assurance team personnel might address self-interest and familiarity threats.

There are circumstances where these safeguards will be inappropriate or ineffective.

### Re-evaluating Threats

300.2 A10 New information or changes in facts and circumstances might:

- (a) Impact the level of a threat; or
- (b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate ~~into~~ address~~ing~~ identified threats.

300.2 A11 Examples of new information or changes in facts and circumstances include:

- When the scope of a professional service is expanded.
- When the client becomes a listed entity or acquires another business unit.
- When the firm merges with another firm.
- Where the engagement partner's immediate family member is recently employed by the client.

In the~~ese~~ situations described above actions already implemented as safeguards might no longer be effective in eliminating those threats or reducing them to an acceptable level.

### Overall Assessment

300.2 A12 When applying the conceptual framework, Section 120 requires that the professional accountant reviews judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated or reduced to an acceptable level and that no further action is needed. The reasonable and informed third party test described in Section 120 is relevant to this assessment. The professional accountant shall communicate with those charged with governance regarding the overall assessment of the engagement.