

Proposed revisions pertaining to safeguards in the Code - phase 2 and related conforming amendments

An exposure draft issued for public consultation by the International Ethics Standards Board for Accountants (IESBA)

Comments from ACCA
April 2017

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Further information about ACCA's comments on the matters discussed here may be requested from:

Ian Waters
Head of Standards
ian.waters@accaglobal.com
+ 44 (0) 207 059 5992

Sundeep Takwani
Director - Regulation
sundeep.takwani@accaglobal.com
+ 44 (0) 207 059 5877

Tech-CDR-1503

ACCA



+44 (0)20 7059 5000



info@accaglobal.com



www.accaglobal.com



The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

ACCA welcomes the opportunity to comment on the proposals.

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GENERAL COMMENTS

ACCA was pleased to have the opportunity to respond to the Phase 1 consultation in March 2016, some of which has been reflected in the Agreed-in-Principle Text, to some extent. In order to provide some context to our response to the Phase 2 consultation, our Phase 1 response is attached as an Appendix. We believe more could be done to try to shape behaviours and attitudes, rather than focus on compliance with the conceptual framework (which is only a means to an end). We also remain concerned that not enough is being done to address one of the main objectives of this Safeguards project, namely to provide practical and effective guidance to SMPs.

A broad perspective of threats and safeguards is required by the professional accountant if he or she is to address appropriately the risk of unethical behaviour. In order to achieve this, a balance must be struck – providing suggestions (ie lists of examples) while encouraging open-mindedness by emphasising that examples given are just that, and are not exhaustive lists.

The increased clarity in drafting throughout the Code, which is one of the objectives of the structure project is not advanced by including superfluous text. For example, we believe that the outcomes from Phase 1 of that project were not intended to impose an 'Introduction' to every subsection of the Code.

We are disappointed to see the inclusion of the word 'effectively' in the definition of 'safeguards' and in paragraph 120.10 A1. It adds nothing to the definition, but risks weakening the impact of safeguards. It is not unusual for the word 'effectively' to imply a rather casual nature, so that actions that 'effectively reduce threats' are not necessarily actions that were *intended* and *designed* to reduce those threats.



AREAS FOR SPECIFIC COMMENT:

In this section, we set out our responses to the request for specific comments set out on pages 16 and 17 of the consultation document.

Provision of Non-Assurance Services to an Audit Client

Question 1: Do respondents support the proposals in Section 600? If not, why not? In particular, do respondents agree with the proposal to extend the scope of the prohibition on recruiting services as described in paragraph 25(h) above to all audit client entities? If not, please explain why.

We broadly support the proposals in section 600. However, care should be taken not to extend the length of the Code as a consequence of inflexible application of the outcomes of Phase 1 of the structure project. Many of our comments below are related to this general observation.

Paragraph 600.4 A2 does not add value. Instead, it implies that changes in the business environment are the main reason that an exhaustive list of permitted non-assurance services cannot be included in the Code. This undermines the conceptual framework approach, and so the paragraph should be removed. (The same is true of paragraph 950.4 A2.)

The application material is important to help the professional accountant identify threats to independence. Therefore, paragraph 600.4 A3 is drafted too narrowly, ie the word 'will' is used where 'might' is more appropriate. (The same is true of paragraph 950.4 A3.) So, in paragraph 600.4 A3, the factors that are relevant should include:

- the nature of the service, and the degree of reliance, if any, that **might** be placed on the outcome of that service as part of the audit
- whether the outcome of the service **might** affect matters reflected in the financial statements on which the firm will express an opinion, and, if so:
 - the extent to which the outcome of the service **might** have a material effect on the financial statements ...

In some of the subsections discussing specific services, these factors are repeated. This lengthens the Code and so, in these places, we would prefer to see references to the conceptual framework. For example, paragraph 606.4 A1 would be replaced by a



reference to the factors in paragraph 600.4 A3 and a reference to the conceptual framework, which would then no longer be required in paragraph 606.2.

With regard to materiality, given the heading 'Materiality in Relation to an Audit Client's Financial Statements', the first sentence of paragraph 600.5 A1 is redundant. The materiality of a threat (or threats) must be considered in combination with all non-assurance services provided, and so paragraph 600.6 A1 should appear under the heading of 'Materiality', ie the heading 'Multiple Non-assurance Services to an Audit Client' should be removed.

The order of paragraphs R600.9 and R600.10 should be reversed. This would allow the removal of the first sentence of R600.10, and also allow R600.9 to be expanded to include a related entity in 600.10 later becoming a public interest entity (PIE).

Although the agreement in principle to the Phase 1 consultation on the structure of the Code determined that there should be an introduction to each section of the Code, it is not necessary to include an introduction to each subsection of the independence sections. Therefore, the first paragraph of each subsection 601 to 610 may be removed, and the second paragraph of each subsection significantly reduced.

Paragraph 601.5 A1 discusses safeguards when providing accounting and bookkeeping services. However, the preceding paragraphs do not explain how such services (which are not the responsibility of management) might present a threat. Therefore, this subsection lacks logical flow.

Paragraph R601.8 provides an exception in respect of PIE audits, although it cross-refers to paragraph R601.6, which in fact concerns non-PIEs.

In respect of administrative services, paragraphs 602.1, 602.3 A1 and 602.3 A2 could all be combined to provide a clear and concise message. The conclusion to that message would be that providing administrative services will rarely create a threat. We hold a similar view in respect of other parts of section 600 (eg paragraphs 604.5 A1, 604.9 A1, 604.12 A1 and 604.15 A1).

With regard to recruiting services, it should be noted that the extension of the prohibition to apply to non-PIEs falls beyond the scope of this safeguards project. Given the safeguards that will be in place to avoid the risk of assuming management responsibility (R600.8), we do not believe that the extension of the prohibition is necessary, and it would be particularly harmful to SMEs.



Provision of Non-Assurance Services to an Assurance Client

Question 2: Do respondents support the proposals in Section 950? If not, why not?

We broadly support the proposals in section 950 but, as that section mirrors some of the provisions in section 600, some of our comments under Question 1 above are relevant to section 950 also.

We assume the final versions of the independence standards will have been carefully reviewed for typing errors, repetition and unnecessary inconsistencies. In particular, unnecessary inconsistencies between sections 600 and 950 risk causing confusion. For example, professional accountants may question why paragraph R950.6 starts with the words 'When providing services ...', whereas paragraph R600.8 starts 'To avoid the risk of assuming management responsibility when providing *non-assurance* services ...' (emphasis added).

Paragraph 950.7 A1 (as stated in the exposure draft) aligns to paragraph 600.6 A1. However, its positioning is completely different in each section. These paragraphs both relate to the combined effect of threats when considering the significance of threats. Therefore, the proposed paragraph 950.7 A1 should follow paragraph 950.4 A4.

Examples of Safeguards

Question 3: Do respondents have suggestions for other actions that might be safeguards in the NAS and other sections of the Code that would meet the revised description of a safeguard?

This is a particular issue for SMPs, and was deemed to be an area of focus for this safeguards project. We acknowledge the difficulty in identifying effective safeguards for a sector in which resources are more limited. However, we believe the IESBA could do more to research additional safeguards that might be appropriate.



Conforming Amendments Arising from the Safeguards Project

Question 4: Do respondents agree with proposed conforming amendments set out in:

(a) Chapter 2 of this document?

(b) The grey text in Chapters 2 - 5 of Structure ED-2?

- (a) Broadly, we agree with the proposed conforming amendments set out in Chapter 2. However, we have concerns about the disregard for the value of consultation in the process of identifying and evaluating threats. We agree that consultation on threats and safeguards is not a safeguard in itself. However, it provides a valuable third party perspective. Therefore, the removal of consultation from paragraph 310.8 A3, for example, should be balanced by suitable reference to consultation in sections 120 and 300.
- (b) We have no comments in respect of the grey text in Chapters 2 to 5 of the structure Phase 2 exposure draft.

Question 5: Respondents are asked for any comments on any other matters that are relevant to Phase 2 of the Safeguards project.

We have no further comments.

General comments

Small and Medium Practices (SMPs)

One of the main objectives of this Safeguards project is to provide practical and effective guidance to SMPs in respect of available safeguards. We are concerned that not enough has, so far, been done to address this. Practitioners often find it difficult to identify effective safeguards, especially in firms in which resources are very limited. It can also be very difficult to terminate an engagement where appropriate safeguards cannot be identified and implemented. We believe the IESBA still has an important role in researching additional safeguards that might be appropriate for SMEs in particular.



Translations

In our responses above, we have referred to inexplicable inconsistencies between different sections. Any confusion caused by such inconsistencies may be compounded in translation.

In the interests of clarity (and, therefore, ease of translation), care should be taken not to extend the length of the Code without good cause. The inflexible application of the outcomes of Phase 1 of the structure project appears to have given rise to a number of superfluous paragraphs, including an 'Introduction' to every subsection of the Code which, in many cases, adds no value.

ACCA



+44 (0)20 7059 5000



info@accaglobal.com



www.accaglobal.com



The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom



ACCA



+44 (0)20 7059 5000



info@accaglobal.com



www.accaglobal.com



The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom



Proposed revisions pertaining to safeguards in the Code - phase 2 and related conforming amendments

Appendix

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+44 (0)20 7059 5000



info@accaglobal.com



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Proposed revisions pertaining to safeguards in the Code – Phase 1

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Comments from ACCA

March 2016

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ACCA



+44 (0)20 7059 5000



info@accaglobal.com



www.accaglobal.com



The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

ACCA welcomes the opportunity to comment on the proposals issued by the International Ethics Standards Board for Accountants (the IESBA). In preparing this response, we have sought to represent the views of members of ACCA's Global Forum for Ethics.

OVERALL COMMENTS

We welcome the objectives of this IESBA project, and agree that specific safeguards now considered inappropriate or ineffective should be clarified or removed from the Code. Focus on the effective application of the conceptual framework is of great importance. Enhanced clarity is, to a great extent, achieved by a well-structured Code that is not of excessive length, and ACCA believes that this should lead to higher ethical standards of behaviour, in the public interest.

We are also pleased that the exposure draft recognises the difficulties faced by small and medium practices (SMPs), which usually have fewer safeguards available to them. However, we believe the proposed changes do not go far enough to achieving improvements in this respect. The background to the exposure draft suggests that the challenges to SMPs arise from them having 'limited resources', although it might be argued that the only relevant limitation is the number of principals and staff available to implement effective safeguards. Clear application material that addresses this specific issue would be welcomed, and we expand on this in some of our responses below.

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SPECIFIC ISSUES

In this section of our response, we answer the five questions set out in the consultation paper section *Request for Specific Comments*.

Proposed revisions to the conceptual framework

Question 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?

A well-structured Code, which is not of excessive length, is important in achieving compliance. Therefore, we support cross-references in section 300 to relevant application material that is already provided in section 120 – a section that must be understood by *all* professional accountants.

The proposed requirement of paragraph R120.3 to apply the conceptual framework may not be the best way to express the fundamental obligations of professional accountants. In essence, the requirements are to comply with the fundamental principles and (equally as important) to safeguard those fundamental principles. To be numb to threats to compliance would be reckless and, in itself, lacking professional behaviour.

We believe the requirements are best expressed in such terms, with the use of the conceptual framework expressed as very important application material. This approach would better help to shape behaviours and attitudes, and so reduce the risk that following the restructured conceptual framework may amount to mere compliance.

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We believe the requirement to remain alert to changing circumstances, and consider the perspective of a reasonable and informed third party is useful. Often, the third party perspective serves as a useful indication of where the public interest lies and, in itself, helps the professional accountant to exercise objectivity.

We support the logical structure of section 120, which runs chronologically through the stages of identifying, evaluating, addressing and re-evaluating threats. We comment on paragraph 120.6, in respect of evaluating threats, under question 2. The other identified stages of the process are considered below.

Identifying threats: Arguably, the most important paragraph in this section is R120.5, as it is a requirement. It states that the professional accountant ‘shall’ identify threats, and so it is assumed that the professional accountant has the skills and resources to do so. This requirement is not supported by the content of paragraphs 120.5 A1 to A3, which focus entirely on the creation of threats, rather than their identification. Paragraph 120.5 A4 lists a number of conditions, policies and procedures that may already exist to make the identification of threats easier, but these may not be under the control of the professional accountant.

Therefore, while we support the proposal to cease referring to circumstances created by the profession, legislation or the work environment as ‘safeguards’, something is clearly missing from this section. In a given situation, it is likely that the professional accountant will be unaware that there is a threat to be identified. Sensitivity to threats is heightened by an understanding of the impact of legal and professional requirements and procedures established in the work environment. (This is especially true in the SMP environment.)

Therefore, guidance is required to make professional accountants more sensitive to threats. This might be through additional guidance material, or by requiring appropriate internal processes, or both. We recognise the ability of professional bodies to support their members in identifying (or being alert to) threats to compliance with the fundamental principles. However, consistent guidance is better achieved through the IESBA – either alongside the Code or within it.

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Addressing threats: We support the proposals, which have the effect of making the professional accountant responsible for identifying and implementing safeguards that are under the professional accountant's control. However, on balance, we believe that a further paragraph (120.7 A3) is required, to illustrate some of the safeguards that are available to address certain threats. In order to retain the conciseness and clarity of section 120, this might take the form of cross-references to sections 200 and 300.

We also have concerns that the word 'significant' in paragraph 120.7 A1 has no agreed meaning in this context. It would assist understanding if the different aspects of significance were considered. These would include the perspective of third parties – not only hypothetical reasonable and informed third parties, but other third parties, whose opinions may have an impact on the reputation of the professional accountant and the profession.

Re-evaluating threats: It is important that the professional accountant remains alert to changes that might impact threats to compliance with the fundamental principles, and we recognise the importance of proposed paragraph R120.8. It is also important that the professional accountant re-evaluates the threats after implementing the appropriate safeguards, in order to assess the extent to which those safeguards have had the anticipated impact on the threats. Although this is linked to paragraph R120.9, we are not satisfied that the point is expressed clearly within the structure currently proposed.

In being alert to changes (paragraph 120.8 A1), the professional accountant must, as stated, have regard to the impact of the changes on the level of the threat and the appropriateness of the safeguards applied. However, we believe that an important factor has been omitted, namely the *appearance* of adequately safeguarding the fundamental principles – the perspective of both hypothetical and actual third parties.

The overall assessment: This paragraph is very important, but it does not state *when* the overall assessment must take place, or what exactly the professional accountant must consider at this stage. The professional accountant must take the time to consider objectively whether the intended outcome of the process has been achieved. This must take place following the implementation of the safeguards that were deemed appropriate. But there might subsequently be indications that an overall assessment is again necessary – perhaps as safeguards become less effective, or the nature of the threats change.

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+44 (0)20 7059 5000



info@accaglobal.com

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There are a number of points at which the professional accountant is required to assess threats and safeguards, and it is important to exercise objectivity at such times. That objectivity may, itself, be threatened. Therefore, the importance of documenting one's assessment (including any consultation process) is clear. This serves as a record and also a safeguard (helping the professional accountant to adopt a third party perspective). We believe that the IESBA should consider the points at which the professional accountant's decision-making process should be documented.

Proposed revised descriptions of 'reasonable and informed third party' and 'acceptable level'

Question 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?

As drafted, the third party test is applied in assessing whether the fundamental principles have been complied with (R120.4) and whether threats to compliance with the fundamental principles have been eliminated or reduced to an acceptable level (R120.9). It is not clear why threats to compliance are not mentioned in paragraph R120.4.

We welcome the explanation in paragraph 120.4 A1 that the reasonable and informed third party is a hypothetical person. The description of the person includes the ability to 'objectively evaluate' certain things, but this hypothetical person could simply be described as 'independent'. If the relevant sections of the Code were to refer to assessment by 'a reasonable and informed independent party', the second sentence of paragraph 120.4 A1 could be removed. Nevertheless, there will always be a high level of subjectivity involved whenever one is expected to consider the perspective of a hypothetical third party.

In our opinion, the proposed paragraphs on evaluating threats are unclear. In particular, 120.6 A1 states:

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‘An acceptable level is a level at which a reasonable and informed third party would likely conclude that the professional accountant complies with the fundamental principles.’

It is an absolute requirement of the Code that the professional accountant complies with the fundamental principles. The conceptual framework exists to safeguard those principles, and minimise the risk that they will be breached in the foreseeable future. Taking the meaning of ‘acceptable level’ as set out in paragraph 120.6 A1, it is unclear to us what difference exists between the elimination of threats to compliance and reducing them to an acceptable level.

Proposed revised descriptions of ‘safeguards’

Question 3: Do respondents support the proposed description of ‘safeguards’? If not, why not?

We support the proposed description, which achieves greater clarity as a result of its brevity. However, as explained under question 1 above, we believe users of the Code would be greatly assisted by examples of safeguards, which could be provided by cross-references to sections 200 and 300 of the restructured Code.

Question 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 characterised 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 ‘safeguards created by the profession or legislation’, ‘safeguards in the work environment’, and ‘safeguards implemented by the entity’ should not be included in the updated understanding of safeguards, which should focus on actions that are available to the professional accountant, rather than existing circumstances. Nevertheless, these existing circumstances are important to the professional accountant’s evaluation of threats. In fact, a professional

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+44 (0)20 7059 5000



info@accaglobal.com



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accountant's sensitivity to threats is heightened by an understanding of the impact of legal and professional requirements and procedures established in the work environment. Therefore, guidance is necessary to explain the impact of these circumstances on the assessment of threats. A clear understanding of such circumstances can underpin the appropriate behaviours of a professional accountant.

Further, the responsibilities of the professional accountant include ethical leadership. Therefore, guidance within the application material, or alongside the Code, should consider the impact that the professional accountant could have on 'safeguards' implemented by the entity.

Proposals for professional accountants in public practice

Question 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?

We support the approach set out in the proposed introduction and overarching requirement, which we believe better aligns the obligations of professional accountants in public practice with the fundamental requirements of proposed section 120. We also agree that it is logical to set out the application material according to the structure of the conceptual framework, ie identifying threats, evaluating threats, addressing threats, re-evaluating threats, and making an overall assessment. We have the following comments under each of these headings:

Identifying threats: Although paragraph 300.2 A1 states that the threats listed are examples, we believe there is value in emphasising that the examples are not exhaustive. Although this suggestion may seem contrary to the objective of keeping the Code concise, we believe such emphasis would have a positive impact on attitudes and behaviours through the addition to the Code of only a few words.

The examples given under 'self-interest threats' all appear to be where the interests of the professional accountant would be very closely aligned with those of the client. We recommend including one or more examples of conflicting

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interests. With this in mind, it might be argued that paragraph 120.5 A2 requires more general information concerning the different types of self-interest.

Evaluating threats: These paragraphs set out various factors that might impact the professional accountant's evaluation of the threats. However, it does not suggest how to evaluate the *overall* threat, which will depend on the ways in which the component threats interact. Perhaps, in some situations, individual threats must be addressed separately, due to their nature. The draft sections of the Code appear to be silent on this.

The section on 'the professional service being provided' (paragraph 300.2 A5) cross-references to the International Independence Standards C1 and C2. This suggests a narrow application of the conceptual framework for professional accountants in public practice. Therefore, we recommend that this paragraph makes very clear the wider significance of the service being provided on the evaluation of threats.

We know that the evaluation of whether the threat is sufficiently low should be that of a hypothetical reasonable and informed third party. However, that is not easy to assess and, before addressing the threats, the professional accountant needs to be able to reach a conclusion regarding evaluation. Section 300.2 does not suggest how to approach this, or how to demonstrate an appropriate conclusion.

Addressing threats: The approach to setting out the example safeguards lacks innovation. One of the objectives of this project is to provide practical and effective guidance to SMPs, but the list in paragraph 300.2 A9 includes only one such safeguard. We suggest it would be useful to categorise different types of safeguard, and then map across to the appropriate types of safeguard from each category of threat. In many cases, for an SMP, the only appropriate safeguard will appear to be the involvement of another firm. But a thorough consideration of threats and available safeguards will highlight a *range* of appropriate safeguards. If SMPs see the involvement of another firm as the only available safeguard, the costs involved may be seen as a barrier to providing certain services. By mapping across from each type of threat to different types of safeguard, it would be possible to highlight the types of safeguard usually available to SMPs in each case. It would then be useful to provide specific, relevant examples within each category of safeguard.

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+44 (0)20 7059 5000



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The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

Re-evaluating threats: As explained under question 1 above, changes in the facts and circumstances will usually come about after implementing appropriate safeguards, and the actual impact of those safeguards should be evaluated after implementation. This evaluation should also consider the *third party perception* of whether or not the fundamental principles have been adequately safeguarded.

Overall assessment: This section is very brief, comprising only two sentences. Please refer to our comments under question 1 above.

GENERAL COMMENTS

ACCA has developed this response following an internal due process, and we have attempted to reflect the opinions of a wide range of stakeholders represented, in part, by members of our Global Forum for Ethics. However, we would make the following further observations, relevant to specific groups of stakeholders.

Small and medium practices (SMPs)

We believe that the proposals are an improvement with regard to the impact that they will have on the understanding of professional accountants within SMPs. The avoidance of duplication, and effective use of cross-referencing, will make the Code more accessible. However, we believe it is important that those working within SMPs must have easy access to more detailed information when they need it. For example, we explain above that examples of appropriate safeguards (or cross-references to them) would be useful in section 120, in order to better explain what safeguards are, while avoiding any suggestion that the range of safeguards generally available is limited.

We explain, under question 5 above, how the examples of safeguards provided in section 300 may be set out in a way that is much more useful to SMPs.

Developing nations

Member bodies in different parts of the world operate within a range of cultural environments. The simplicity of the proposed structure of section 120, which remains principles-based, can help by providing a clearer framework, while

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+44 (0)20 7059 5000



info@accaglobal.com



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The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

providing the flexibility for tailored implementation guidance by professional bodies. There remains, however, a responsibility of the IESBA to provide detailed guidance, for those who might benefit from it, which would aid consistency of understanding and interpretation across all the IFAC member organisations.

Translations

The proposals would appear to include clarified language, consistent definitions and logical structure. We are not aware of any potential translation issues. However, this is a very important consideration, and we would be interested in any issues identified by other respondents.

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+44 (0)20 7059 5000



info@accaglobal.com



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The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom