

# Proposed revisions pertaining to safeguards in the Code – Phase 1

An exposure draft issued by the International Ethics Standards Board for Accountants

Comments from ACCA

March 2016

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Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 178,000 members and 455,000 students in 181 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 95 offices and centres and more than 7,110 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

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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.

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## 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.



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.



*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.



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:

‘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



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



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 of 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.



*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.

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## 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



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.



Think Ahead

