

### Safeguards—Proposed Revisions to Sections 100 and 200 of the Code

[CLEAN]

The scope of the Safeguards project scope<sup>1</sup> is limited to certain paragraphs within Section 100,<sup>2</sup> Section 200<sup>3</sup> and Section 290.<sup>4</sup> Certain paragraphs of the Code have been re-positioned, but have otherwise not been changed. They are included in this paper to assist readers in understanding the flow of Revised Sections 100 and 200 and are shaded in grey text. ***The Safeguards Task Force is not seeking feedback on the shaded grey text, but would welcome any IESBA views on its positioning.***

The Safeguards Task Force plans to consider the nature and extent of any conforming changes resulting from its proposals relating to Sections 100 and 200 at its October 2015 meeting.

The Safeguards Task Force is of the view that its proposals meet the new structure and drafting conventions developed by the Structure Task Force.

## A. SECTION 100

### Introduction and Fundamental Principles

#### Introduction

- 100.1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant shall observe and comply with this Code. If a professional accountant is prohibited from complying with certain parts of this Code by law or regulation, the professional accountant shall comply with all other parts of this Code.
- 100.2 This Code contains three parts. Part A establishes the fundamental principles of professional ethics for professional accountants. It also describes the conceptual framework that the Code requires professional accountants to apply to identify, evaluate, and address the threats to compliance with the fundamental principles.

<sup>1</sup> The January 2015 approved Safeguards Project Proposal indicate that the Safeguards project scope will encompass:

- The subsection entitled *Threats and Safeguards* (paragraphs 100.12–100.16) in Section 100.
- The subsection entitled *Threats and Safeguards* (paragraphs 200.3–200.15) in Section 200.
- The subsection entitled *Application of the Conceptual Framework Approach to Independence* (paragraphs 290.100 to 290.101) in Section 290.
- The subsection entitled *Provision of Non-Assurance Services to an Audit Client* (paragraphs 290.154 to 290.216) in Section 290.
- Necessary conforming changes to Section 291 resulting from any of the potential changes to Section 290.

<sup>2</sup> Section 100, *Introduction and Fundamental Principles*

<sup>3</sup> Section 200, *Introduction (Professional Accountants in Public Practice)*

<sup>4</sup> Section 290, *Independence – Audit and Review Engagements*

- 100.3 Parts B and C describe how the conceptual framework applies in certain situations. Part B applies to professional accountants in public practice. Part C applies to professional accountants in business. Professional accountants in public practice may also find Part C relevant to their particular circumstances.
- 100.4 The use of the word “shall” in this Code imposes a requirement on the professional accountant or firm to comply with the specific provision in which “shall” has been used. Compliance is required unless an exception is permitted by this Code.

### **Fundamental Principles**

- 100.5 A professional accountant shall comply with the following fundamental principles:
- (a) Integrity – to be straightforward and honest in all professional and business relationships.
  - (b) Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.
  - (c) Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
  - (d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
  - (e) Professional Behavior – to comply with relevant laws and regulations and avoid any action that discredits the profession.

Each of these fundamental principles is discussed in more detail in Sections 110–150.

### **Conceptual Framework**

- 100.6 The circumstances in which professional accountants operate may create specific threats to compliance with the fundamental principles. The conceptual framework assists the professional accountant in complying with the fundamental principles while meeting the responsibility to act in the public interest. It accommodates many variations in circumstances that create threats to compliance with the fundamental principles and can deter a professional accountant from concluding that a situation is permitted if it is not specifically prohibited.
- 100.7 The conceptual framework specifies an approach for the professional accountant to:
- (a) Identify threats to compliance with the fundamental principles;
  - (b) Evaluate the threats identified; and
  - (c) Address the threats by eliminating or reducing them to an acceptable level.

## Requirements and Application Material

- 100.8 The professional accountant shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles.
- 100.9 When applying the conceptual framework, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party would likely conclude that compliance with the fundamental principles is not compromised.

### Reasonable and Informed Third Party

- 100.10 A reasonable and informed third party is a conceptual person who possesses suitable skills, knowledge and experience to evaluate the appropriateness of the professional accountant's conclusions. This evaluation entails weighing all the specific facts and circumstances that the professional accountant knows, or could reasonably be expected to know, at the time, to objectively determine whether the relevant threats to compliance with the fundamental principles will be eliminated or reduced to an acceptable level.

### Identifying Threats

- 100.11 An understanding of the circumstances or relationships that may compromise compliance with the fundamental principles is a prerequisite to the professional accountant's identification of threats to such compliance.
- 100.12 Threats may be created by a broad range of relationships and circumstances. However, it is impossible to define every situation that creates threats to compliance with the fundamental principles. In addition, the nature of engagements and work assignments may differ and, consequently, different threats may be created. When a circumstance or relationship creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle.
- 100.13 Threats to compliance with the fundamental principles fall into one or more of the following categories:
- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behavior;
  - (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made, or activity or service performed by the professional accountant, or by another individual within the professional 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;
  - (c) Advocacy threat – the threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised;
  - (d) 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

- (e) 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 professional accountant.

### **Evaluating Threats**

- 100.14 When the professional accountant identifies a threat, the application of the conceptual framework calls for the professional accountant to evaluate whether such threat is at an acceptable level. This evaluation involves weighing all the facts and circumstances available at the time of the activity or service. 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.
- 100.15 A threat will not be at an acceptable level if any of the fundamental principles is compromised or would likely be compromised.
- 100.16 The existence of conditions established by the profession, legislation, regulation, the firm or the employing organization may impact the level of the threat to compliance with the fundamental principles and can affect the likelihood of identifying or deterring unethical behavior. Examples of these conditions 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.

### **Addressing Threats**

- 100.17 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the application of the conceptual framework calls for the identification and application of safeguards to eliminate those threats or reduce them to an acceptable level.
- 100.18 When safeguards are not available, or cannot be applied, to eliminate the identified threats to compliance with the fundamental principles or reduce them to an acceptable level, the application of the conceptual framework requires the professional accountant to decline or discontinue the specific professional activity or service involved.

### *Safeguards*

- 100.19 Safeguards are specific actions or other measures that the professional accountant takes to effectively eliminate identified threats to compliance with the fundamental principles or reduce them to an acceptable level. Safeguards, which may be individual or a combination of specific actions or other measures, are effective when they eliminate or reduce the level of the threat to an acceptable level, such that the fundamental principles are not compromised, or are not likely to be compromised.

## Re-evaluation of Threats and Safeguards

100.20 Facts and circumstances may change over time and new information about threats and the appropriateness of safeguards may come to the attention of the professional accountant. In such cases, the conceptual framework calls for a re-evaluation of the threats and safeguards if the changed or new information indicates an inconsistency with the professional accountant's original identification and evaluation of threats. Remaining alert throughout the professional activity or service assists the professional accountant in identifying changes in facts and circumstances that may result in threats to compliance with the fundamental principles.

## Conflicts of Interest

100.17 A professional accountant may be faced with a conflict of interest when undertaking a professional activity. A conflict of interest creates a threat to objectivity and may create threats to the other fundamental principles. Such threats may be created when:

- The professional accountant undertakes a professional activity related to a particular matter for two or more parties whose interests with respect to that matter are in conflict; or
- The interests of the professional accountant with respect to a particular matter and the interests of a party for whom the professional accountant undertakes a professional activity related to that matter are in conflict.

100.18 Parts B and C of this Code discuss conflicts of interest for professional accountants in public practice and professional accountants in business, respectively.

## Ethical Conflict Resolution

100.19 A professional accountant may be required to resolve a conflict in complying with the fundamental principles.

100.20 When initiating either a formal or informal conflict resolution process, the following factors, either individually or together with other factors, may be relevant to the resolution process:

- (a) Relevant facts;
- (b) Ethical issues involved;
- (c) Fundamental principles related to the matter in question;
- (d) Established internal procedures; and
- (e) Alternative courses of action.

Having considered the relevant factors, a professional accountant shall determine the appropriate course of action, weighing the consequences of each possible course of action. If the matter remains unresolved, the professional accountant may wish to consult with other appropriate persons within the firm or employing organization for help in obtaining resolution.

100.21 Where a matter involves a conflict with, or within, an organization, a professional accountant shall determine whether to consult with those charged with governance of the organization, such as the board of directors or the audit committee.

100.22 It may be in the best interests of the professional accountant to document the substance of the issue, the details of any discussions held, and the decisions made concerning that issue.

- 100.23 If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from the relevant professional body or from legal advisors. The professional accountant generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege. Instances in which the professional accountant may consider obtaining legal advice vary. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant may consider obtaining legal advice in that instance to determine whether there is a requirement to report.
- 100.24 If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall, where possible, refuse to remain associated with the matter creating the conflict. The professional accountant shall determine whether, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

#### **Communicating with Those Charged with Governance**

- 100.25 When communicating with those charged with governance in accordance with the provisions of this Code, the professional accountant or firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the professional accountant or firm communicates with a subgroup of those charged with governance, for example, an audit committee or an individual, the professional accountant or firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

## **B. SECTION 200**

### **Introduction**

- 200.1 It is in the public interest and, therefore required by this Code, that professional accountants in public practice comply with fundamental principles and apply the conceptual framework contained in Part A of the Code. Part A of the Code describes the conceptual framework, which specifies an approach for the professional accountant to identify, evaluate and address threats to compliance with the fundamental principles. This part of the Code describes the application of the conceptual framework with respect to professional accountants in public practice.
- 200.2 A professional accountant in public practice shall not knowingly engage in any business, occupation, or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the fundamental principles.

## Requirements and Application Material

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

200.3 In accordance with Part A of the Code, the professional accountant in public practice shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles.

### Identifying Threats

200.4 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances and relationships. This Part does not describe all of the circumstances and relationships that could be encountered by a professional accountant in public practice that create or may create actual or perceived threats to compliance with the fundamental principles. An understanding of the circumstances or relationships that may compromise compliance with the fundamental principles is a prerequisite to the professional accountant in public practice's identification of threats to such compliance.

#### *Types of Threats*

200.5 The following are categories of threats, and examples of circumstances that create those threats for a professional accountant in public practice when undertaking an activity or providing a service:

(a) Self-interest Threats

- (i) A member of the assurance team having a direct financial interest in the assurance client.
- (ii) A firm having undue dependence on total fees from a client or the possibility of losing a significant client.
- (iii) A member of the assurance team having a significant close business relationship with an assurance client.

(b) Self-review Threats

- (i) A firm issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- (ii) A firm having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- (iii) A member of the assurance team 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 of the engagement.

(c) Advocacy Threats

- (i) The firm promoting shares in an audit client.
- (ii) A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

(d) Familiarity Threats

- (i) 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 who is in a position to exert significant influence over the subject matter of the engagement.
- (ii) A director or officer of the client or an employee in a position to exert significant influence over the subject matter of the engagement having recently served as the engagement partner.
- (iii) Senior personnel having a long association with the assurance client.

(e) Intimidation Threats

- (i) A firm being pressured by a client.
- (ii) A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
- (iii) A professional accountant being informed by a partner of the 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 discussed in further detail in Part A of the Code.

### **Evaluating Threats**

200.6 The evaluation of whether a threat is at an acceptable level depends on:

- (a) The nature of the engagement and the structure of the firm.
- (b) Qualitative and quantitative factors, as well as, the combined effect of multiple threats, if any.
- (c) Weighing all the facts and circumstances and relationships at the time of the activity or service.

The exercise of professional judgment, is critical to the professional accountant in public practice's application of the conceptual framework to evaluate threats to compliance with the fundamental principles, taking into account the perspective of a reasonable and informed third party as described in Part A.

200.7 The level of a threat to compliance to the fundamental principles depends on the nature of the professional activity or service. It may also differ depending on whether such activity or service arises in relation to:

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



- 200.8 The level of a threat to compliance with the fundamental principles may also be affected by matters unique to the environment in which a firm operates, including the size, structure and organization of the firm.
- 200.9 Conditions may exist in the work environment or within a firm that may affect the level of a threat to compliance with the fundamental principles. Those conditions will vary depending on the circumstances. Examples of such conditions include:
- (a) Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that professional accountants will act in the public interest.
  - (b) Methods and processes for establishing and monitoring compliance with the fundamental principles by all personnel.
  - (c) Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.
  - (d) Management of the reliance on revenue received from a single client.
  - (e) The engagement partner having authority for compliance with the fundamental principles, including decisions about the permissibility of services to an audit client.
  - (f) Educational, training and experience requirements.
  - (g) Processes to facilitate and address internal and external complaints and to draw attention to unprofessional or unethical behavior.
- 200.10 Depending on the nature of the engagement, a professional accountant in public practice may also be able to rely on conditions that exist within the entity's systems and procedures. However, it is not possible to rely solely on those conditions to eliminate or reduce threats to compliance with the fundamental principles to an acceptable level.
- 200.11 Examples of conditions that may exist within an entity's systems and procedures include:
- (a) The client requires persons other than management to ratify or approve the appointment of a firm to perform an engagement.
  - (b) The client has competent employees with experience and seniority to make managerial decisions.
  - (c) The client has implemented internal procedures that ensure objective choices in commissioning non-assurance engagements.
  - (d) The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

### **Addressing Threats**

- 200.12 If the professional accountant in public practice determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the application of the conceptual framework calls for the identification and application of safeguards to eliminate those

threats to compliance with the fundamental principles or reduce them to an acceptable level. The term “safeguards” is further described in Part A of the Code.

- 200.13 In the work environment, the relevant safeguards may vary depending on the circumstances. Examples of engagement-specific safeguards in the work environment include:
- (a) Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
  - (b) Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
  - (c) Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
  - (d) Discussing ethical issues with those charged with governance of the client.
  - (e) Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
  - (f) Involving another firm to perform or re-perform part of the engagement.
  - (g) Rotating senior assurance team personnel.
- 200.14 It may be necessary for the professional accountant in public practice to decline or discontinue the specific professional activity or service involved, or resign from the engagement if the threats to compliance with the fundamental principles are not eliminated or reduced to an acceptable level.

#### **Re-evaluation of Threats and Safeguards**

- 200.15 Facts and circumstances may change over time and new information about threats and the appropriateness of safeguards may come to the attention of the professional accountant in public practice. In such cases, the conceptual framework calls for a re-evaluation of the threats and safeguards if the changed or new information indicates an inconsistency with the professional accountant in public practice's original identification and evaluation of threats. Remaining alert throughout the professional activity or service assists the professional accountant in public practice in identifying changes in facts and circumstances that may result in threats to compliance with the fundamental principles.