

18 March 2016

Mr Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, NY 10017
USA

Dear Ken,

IESBA Exposure Draft *Proposed Revisions Pertaining to Safeguards in the Code-Phase 1*

Thank you for the opportunity to comment on the IESBA exposure draft of proposed revisions pertaining to safeguards in the Code Phase 1. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

Overall summary

The NZAuASB is very supportive of the project to improve the clarity, appropriateness and effectiveness of the safeguards in the Code. The NZAuASB supports the IESBA's efforts to strengthen emphasis on compliance with the fundamental principles throughout the Code and application of a clarified conceptual framework to enhance a principled based approach to the Code, with emphasis on the need to apply professional judgement. The NZAuASB also supports the IESBA continuing to promote and emphasise this approach when part 2 of this project progresses.

The NZAuASB is supportive of the proposed new separate conceptual framework section 120, and the use of additional headings to provide more emphasis on the conceptual framework approach. The NZAuASB also supports linking the examples of safeguards to the threats they may address, and considers this may assist practitioners to apply the framework. The proposed streamlined language makes the requirements and guidance clearer. The NZAuASB does however recommend that the additional steps of re-evaluating the threats and performing an overall assessment should be added to proposed section 120.2 in order to provide a full list of the approach as proposed (further detail on this recommendation is detailed in the attachment). Use of similar headings in proposed section 300 assists in promoting and emphasising the conceptual framework approach.

The NZAuASB also considers that further clarification could be made of the reasonable and informed third party test as outlined in the attachment below.

The NZAuASB is supportive of all efforts to enhance consistent application of the framework but considers that efforts to clarify the Code may not be effective on its own to improve application of the threats and safeguards framework in practice. The NZAuASB understands that one objective of this project was to eliminate duplication between the Code of Ethics and the quality control and auditing standards. The NZAuASB is supportive of all efforts by the IESBA to work closely with the IAASB and IAESB to promote consistent application.

The NZAuASB further encourages the IESBA to continue to work with the IAASB and the IAESB, as well as regulators, those charged with governance and management not only on the safeguards project but more broadly to promote consistent application with a focus on audit quality by all participants in the financial reporting chain.

In formulating this response, the NZAuASB sought input from New Zealand constituents.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk (sylvia.vandyk@xrb.govt.nz).

Yours sincerely,

A handwritten signature in blue ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

Neil Cherry

Chairman – New Zealand Auditing and Assurance Standards Board
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Submission of the New Zealand Auditing and Assurance Standards Board

IESBA Exposure Draft *Proposed Revisions Pertaining to Safeguards in the Code-Phase 1*

I Schedule of Responses to the IESBA's Questions

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:

Response:

The NZAuASB is supportive of creating a separate section covering the conceptual framework, and considers that this may strengthen the emphasis and application of a clarified conceptual framework. In addition, the NZAuASB supports the explicit and overarching requirement to apply the conceptual framework to eliminate or reduce threats to compliance (R120.3), as well as the proposed overarching requirement, supplemented explicit requirements and application material with respect to each step in the framework.

The NZAuASB supports the clearer description of the conceptual framework approach in proposed paragraph 120.2. However, this description is incomplete given the proposed additional requirements to re-evaluate the threats and perform an overall assessment. The NZAuASB recommends that these headings should be added to 120.2 as bullets (d) and (e). Also 120.2 and R120.3 are repetitive and the NZAuASB queries the need for both paragraphs. The NZAuASB recommends that these paragraphs should be combined, and that bullets should be used to outline the steps involved as drafted in paragraph 120.2.

The NZAuASB supports the use of the additional headings throughout section 120.

(a) Identifying threats;

The NZAuASB is supportive of the explicit requirements to identify threats, but recommends that this should be clarified to include the word "any" as follows, "the professional accountant shall identify any threats ..." as there may not always be a threat to identify.

The NZAuASB is supportive of retaining the description of threats as described in the extant Code.

The NZAuASB considers that the positioning of proposed 120.5 A4 is confusing. This paragraph describes examples of conditions, policies and procedures that can affect the **identification** of threats, including corporate governance requirements, education, training and experience requirements, compliance systems, duty to report breaches and monitoring and disciplinary procedures. The NZAuASB agrees that these conditions, policies and procedures may impact on the level of the threat, rather than the existence of the threat and therefore queries the term "identification". The NZAuASB agrees that these factors are not 'safeguards' and might impact on the accountants **evaluation** of the threat, but query whether this is appropriate for the **identification** of the threat. The NZAuASB recommends that this should be further clarified or moved to the section on evaluating threats. This is already cross referred to in proposed paragraph 120.6 A3.

(b) Evaluating threats;

The NZAuASB is supportive of any additional application material that may assist to describe the process by which a professional accountant should evaluate threats. Clarification to the term "acceptable level" is also helpful, refer question 2 below.

(c) Addressing threats;

The NZAuASB is supportive of the proposed revised use of the term safeguards, refer question 2 below. The NZAuASB have no further recommendations to proposed R120.7 or the accompanying application material.

(d) Re-evaluating threats; and

The NZAuASB is supportive of the proposed new requirement to re-evaluate the threat. The NZAuASB considers that this addition may promote the use of the conceptual framework, a framework that needs to be objectively applied on a continual basis, rather than just as background information. The NZAuASB is of the view that this requirement is part of the conceptual framework and should be described as such in 120.2, see recommendation above.

(e) The overall assessment.

The NZAuASB is supportive of the proposed new requirement to perform an overall assessment by reviewing judgements made and conclusions reached. The NZAuASB considers that this proposed requirement strengthens the framework. Further, this requirement is part of the conceptual framework and should be described as such in 120.2, see recommendation above.

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

The NZAuASB is supportive of the proposed description of the term “reasonable and informed third party”.

The NZAuASB considers that the informed third party test should apply at all stages of the framework, in identifying, evaluating and addressing threats. For this reason the NZAuASB is supportive of the reference to the third party in R120.4. The positioning of the description of the “reasonable and informed third party” then follows in 120.4 A1. The NZAuASB notes however that explicit reference is made to the third party in evaluating the threat and again at the overall assessment stage. The NZAuASB however considers that the third party test would also apply to identifying any threat and in determining whether the threats have been addressed. If so, this should also be explicitly stated at each stage.

(b) “acceptable level” in the Code. If not, why not?

Response:

The NZAuASB is supportive of the proposed description of “acceptable level”.

Proposed Revised Description of Safeguards

3. Do respondents support the proposed description of “safeguards?” If not, why not?

Response:

The NZAuASB supports the proposed description of “safeguards”.

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?

Yes, the NZAuASB agrees that these are not safeguards.

(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?”

Response:

As discussed above, the NZAuASB agrees that these are conditions that potentially affect the evaluation of the threats, but that it is less clear how these conditions affect the existence or identification of the threat.

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?

Response:

The NZAuASB is supportive of the approach to the proposed revised section 300, that is, of the overarching requirement to apply the conceptual framework and the use of headings with appropriate application material under each section to place greater emphasis on the conceptual framework approach.

The NZAuASB urges that IESBA carefully considers the use of the term “firm” or “professional accountant in public practice”. It appears that these terms are not used consistently. The NZAuASB understands that IESBA is considering the clarity of responsibility of individual accountants and firms under the restructuring of the Code project, but considers that the examples of threats identified in section 300 is another area where the use of these terms would benefit from clarification. The NZAuASB recommends that where appropriate the Code should be written to be applied by both individuals on an engagement team and the firm collectively, or appropriately identify the responsible party.

The addition of examples of the types of threats that safeguards may address is particularly helpful. The NZAuASB therefore considers that there is no need to streamline the examples used and considers that the following examples that have been removed should be retained, whilst indicating that the examples are not exhaustive:

Self-interest threats:

- A member of the audit team entering into employment negotiations with the audit client;
- A firm entering into a contingent fee arrangement relating to an assurance engagement
- A professional accountant discovering a significant error when evaluating the results of a previous professional service performed by a member of the professional accountant’s firm

Self-review threats

- The firm performing a service for an assurance client that directly affects the subject matter information of the assurance engagement.
- A professional accountant accepting gifts or preferential treatment from a client, unless the value is trivial or inconsequential.

Using different partners and engagement teams with separate reporting lines for the provision of NAS to an assurance client may not address the self-review threat, which is described in 120.5 A2 as “the threat that a professional accountant will not appropriately evaluate the results of a previous judgement made, or activity or service performed by...another individual within the accountant’s firm”. In some instances, creating “information barriers” is the only practical solution for dealing with a self-review threat, however, these information barriers need to be properly implemented and effectively monitored to ensure that they are effective in dealing with the threat. These barriers need to be well documented to be able to reassure clients and possibly others that the barrier is effective, i.e. they should be able to withstand external scrutiny not just meet internal processes.

The NZAuASB notes that the examples of threats in proposed section 300 have been widened to refer to professional accountants, instead of members of the assurance team in many instances. The NZAuASB agrees that this is appropriate given that section 300 applies to all professional accountants in public practice and not just to those performing assurance engagements. (For example, a self-interest threat is a professional accountant having a direct financial interest in a client.) The independence sections will cover more specifically the prohibitions, threats or safeguards appropriate for a member of an audit or assurance team. The NZAuASB notes however that this has not been consistently done, and recommend that the following examples should also be broadened:

Self-review threats (300.2 A1):

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.

We note that this example is assurance specific and will be dealt with specifically in C1 and C2, whereas the example of the firm performing a service for a client that directly affects the subject matter information of the engagement has been omitted. This example may be a more generic example for professional accountants in public practice and we recommend that the assurance example should rather be omitted at this stage and dealt with in C1 and C2, and the more generic example retained in section 300.

Advocacy threats

- A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties

The NZAuASB considers that this example is assurance specific and is dealt with in the independence sections. Inclusion here is unnecessarily repetitive. We recommend that in proposed section 300 a more generic example may be more appropriate.

Familiarity threats

- Senior personnel having a long association with the assurance client.

This threat is specific to an assurance client and will be dealt with specifically C1 and C2. The NZAuASB therefore queries the need to include this as an example for all professional accountants in public practice in section 300.

Intimidation threats

- 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.

This threat may apply more broadly than to an audit client. The NZAuASB therefore recommends that the term "audit" could be removed.