

25 April 2017

Mr. Ken Siong
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International Ethics Standards Board
for Accountants
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submitted electronically through the IESBA website

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Re.: Proposed Revisions Pertaining to Safeguards in the Code – Phase 2 and Related Confirming Amendments

Dear Mr. Siong,

The IDW appreciates the opportunity to comment on the above mentioned Exposure Draft and proposed changes to the Code of Ethics for Professional Accountants hereinafter referred to as “the ED” and “the Code”, respectively.

In this letter we submit general comments and respond to the questions raised within the IESBA’s request for comments in an Appendix to this letter.

General Comments

Support for a Clear and Concise Code

As previously expressed in our comment letter dated 21 March 2016, the IDW supports the IESBA’s Safeguards initiative. Achieving a Code that is clearer and easier to read is in the public interest, not least because it will be more suitable for impacting the behavior of professional accountants in practice. Whilst the ED includes many requirements expressed more clearly, we also note, however, instances in the ED where proposed revisions of subsections of the extant Code mean that certain sections would become far longer and repetition introduced.

Subsection 607 provides just one example where two paragraphs have been increased to make five. At the very least we question whether adding new text as an “introduction” in each subsection has added value.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB;
Dr. Daniela Kelm, RA LL.M.

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The explanatory memorandum mentions the notion of (unnecessary) repetition between the IESBA Code and ISQC 1 and ISAs. There is still material that could be streamlined or removed to reduce duplication.

Challenges to Potential Commenters

The complexity, volume, and interaction of this ED with other material at various stages of development combined with the fact that the IESBA has addressed both this and the related Structures project in two-phases means that following these proposals is challenging.

In addition, the issuance of three documents for comment within such a relatively short period of time inevitably increases the challenge to those wishing to comment.

Those wishing to comment may well find it difficult to determine whether issues have or have not been previously exposed, and when. In this context, whilst we agree that the proposed replacement of the term “significant” with “an acceptable level” in relation to the evaluation of threats is a step in the right direction, we note the similarity between the IESBA’s treatment of threat evaluation and the approach to risk adopted by the IAASB and their use of the term “reduced to a suitably low level”. As PPAPs familiar with the IAASB’s standards are familiar with this concept, we would suggest that IESBA’s alignment of terminology in finalizing the restructured Code be given a more thorough consideration.

The Link Between Non-Audit Services and the Code’s Fundamental Principles

Under the Code’s new structure Section 600 forms part of the Independence Standard “Part 4A”. The relationship between independence and the Code’s fundamental principles is explained in paragraph 400.5, which links independence to the fundamental principles of objectivity and integrity, but not to the other fundamental principles.

The second sentence of 600.2 of the ED is based on 290.154 of the extant Code which reads “Providing non-assurance services may create threats to the independence of the firm or members of the audit team”. The proposed insertion of a reference to the fundamental principles in 600.2 (without specifying which ones) means that the scope becomes unclear. This proposed addition is thus not helpful.

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Coordination between IESBA and the IAASB

In our comment letter dated 21 March 2016 on phase 1 of the Safeguards project we had previously expressed support for IESBA working alongside the IAASB in their project on quality control at firm level. As certain issues are common to both the Code and the ISQC 1 and certain ISAs we were disappointed to note that such coordination is not really evident. Parts of the ED remain repetitive of requirements applicable to audit firms in the IAASB's ISQC 1 and certain ISAs.

Extension of a Specific Prohibition from PIE-Audit Clients to All Audit Clients

The most significant revision contemplated in phase 2 of this project concerns the proposed extension in paragraph R609.6 of a prohibition currently applicable only to audits of PIEs.

This change would mean that audit clients – irrespective of their circumstances or degree of public interest significance – could no longer turn to their auditor for relatively routine assistance in recruiting a director or officer of the entity or senior management in a position to exert significance over the preparation of the client's accounting records or financial statements that will be subject to audit.

We do not believe this change is warranted in the manner proposed and refer to our response to question no. 1 in the appendix to this letter, where we explain our views on this particular issue.

Inconsistent Use of Terminology

In both general sections 600 and 950 the single overarching requirement is for the firm to determine whether providing a particular non-audit service would create a threat to the firm's independence to an audit client (R600.4 and R950.4). Given the Code's threats and safeguards approach outlined in section 120 whereby the professional accountant is required to apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles, the use of the term "determine" in R600.4 and R950.4 is not clear.

We note that elsewhere in the Code the term "determine" is used in relation to the level of threat (see R120.10, R270.5, R400.31, R400.75, R410.7, 900.22A1, R940.5). However this is not always consistent – e.g., 600.4A1 refers to "...analyzing...threats", 600.4A3 to "...evaluating the level of any threats..."

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It would be consistent for the overarching requirements pertaining to non-assurance services to explicitly encompass the notions of both identification and evaluation. Furthermore, as threats are to be addressed by eliminating or reducing them to an acceptable level, there is an implication that a threat below the threshold of “acceptable level”, would not need to be included within this requirement – this similarly requires clarification.

We firmly believe that consistent use of terminology is needed throughout the Code and suggest the IESBA review this matter and make the necessary changes to terminology in phase 2.

Delineation Between Requirements and Guidance

The new text introduced in 600.6.A1 and 950.7A1 is presented as application material. However, it actually requires an additional consideration of the combined impact when a firm or network provides more than one NAS. If retained, these paragraphs ought to be rephrased as requirement paragraphs. It would also be helpful for IESBA to clarify how any such requirement would be intended to work in practice. Specifically does IESBA expect that the perception of the combined threat can exceed the perceived sum of the individual threats? Further clarification and possibly guidance is therefore needed in this area in both sections 600 and 950.

In many cases the IESBA proposes a short requirement separate from safeguards, placing possible safeguards within application material. In contrast, R606.5 is particularly long and combines two previous paragraphs so as to mix requirements and safeguards. Revision of this text to provide clearer requirements would be helpful.

Public Expectations

The IAASB’s ISQC 1.21 et seq. require firms to “establish policies and procedures designed to provide the firm with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements maintain independence”.

We are concerned that the IESBA proposals may give the impression that a higher degree of precision is attainable, since when R600.4 is read in conjunction with 600.4A2 it becomes clear that the overriding requirement to determine whether a NAS would or would not create a threat applies to each and every NAS that a firm may be asked to provide; not only those specifically dealt with in subsequent subsections of section 600. There needs to be a clear acceptance that only threats above a certain threshold fall under this

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consideration. For example where any threat from a service is clearly trivial it would be appropriately disregarded, particularly in terms of documentation requirements. In the absence of appropriate clarification others including regulators, peer reviewers etc. will make their own demands in this area.

Implications of Application of Technology for Service Provision by Firms

We note that proposed 600.4A2 and 950.4A2 explain that various changes make it impossible to draw up an exhaustive list of non-assurance services in these two sections. We would, however, have expected IESBA to explicitly address issues such as the (growing) use of technology by firms who provide accounting and bookkeeping services within its Safeguards project. In a number of jurisdictions firms offer a range of accounting services using cloud-based technology. This use of technology will potentially impact a number of issues relevant to the Code, including but not necessarily limited to client confidentiality and accounting and bookkeeping services. Conceivably, safeguards could include having in place adequate data security (confidentiality) or in an area where the PPAPs professional involvement is reduced (bookkeeping automation might impact issues beyond that of a routine or mechanical nature). Of course there may be threats created too. We would encourage the IESBA to explore this further.

We trust that our comments will be received in the constructive manner in which they are intended. If you have any questions relating to our comments in this letter, we should be pleased to discuss matters further with you.

Yours truly,

Klaus-Peter Feld
Executive Director

Helmut Klaas
Director European Affairs

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Appendix

Request for Specific Comments

Section 600, Provision of Non-Assurance Services to an Audit Client

1. *Do respondents support the proposals in Section 600? If not, why not? In particular, do respondents agree with the proposals to extend the scope?*

We comment on specific aspects as follows:

Recruiting Services – R609.6

We do not believe that IESBA has provided sufficient justification for the proposed extension of the prohibition in R609.6 to all audits. For many non-PIEs, and smaller SMEs in particular, the auditor may be the most appropriate person to assist in the recruitment of key personnel, particularly where an audit client's staff may be less able to define a profile for potential candidates. We fail to see the potential for a significant self-interest threat where relatively routine assistance such as seeking possible candidates and performing reference checks are concerned.

Avoiding Management Responsibilities – R600.8

Proposed R600.8 is derived from paragraph 290.162 of the extant Code. In our view, it would have been appropriate for the IESBA to address a practical issue that is problematical in an SME environment. The requirement for the firm (or network firm) to ensure that the client's management delegates an individual who possesses suitable skills, knowledge and experience to be responsible at all times for the client's decisions and to oversee the non-audit service will be problematical for any entity that lacks such an individual, in particular, for SMEs whose employees and management will often comprise so called all-rounders. Indeed they may seek to engage the auditor solely to benefit from his or her expertise. We fully accept that it is important that client management takes full responsibility for the outcome of a non-assurance service provided to an audit client. However, we believe that there needs to be more flexibility in prescribing the exact way in which this responsibility is acknowledged by the audit client. We suggest the IESBA move this part of the proposed requirement to application material, as this should be a possible safeguard rather than a requirement in every case.

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Section 950, Provision of Non-Assurance Services to an Assurance Client

2. *Do respondents support the proposals in Section 950? If not, why not?*

The main concern we have in this section in the Code relates to expectations, and their impact on documentation levels, which is a practical and cost issue in the provision of many services subject to competition from within but also outside of the profession. We refer to our comment letter to which this appendix is attached.

Examples of Safeguards

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?*

Whilst we do not intend to supply a list of additional safeguards, we believe a flexible approach is needed, as it is important that a safeguard shall “match” the degree of threat in individual circumstances. It would be useful if IESBA could emphasize the fact that the circumstances for non-PIE clients are generally very different for those pertaining to larger and PIE audit clients. In particular, public perceptions particularly concerning independence in appearance play a more prominent role in assessing what is an acceptable level.

Confirming Amendments Arising from the Safeguards Project

4. *Do respondents agree with the proposed confirming amendments set out in:*

- a) *Chapter 2 of this document*
- b) *the gray text in Chapters 2-5 of Structure ED-2?*

The proposed introduction of the term “questionable issues” in 320.4A2 may be problematical without further clarification of what this term means in a practical sense. It may also be difficult on translation. Also it leaves open the question of whether – in the absence of questionable issues – there is a need to consider client commitment in this area at all.

320.6A3 may be problematical in some jurisdictions where client confidentiality requirements may require client permission for auditors to exchange information unless prescribed for in law. This should be acknowledged in the Code.

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Our understanding of the IESBA's decision to "reclassify" certain safeguards as factors that impact the evaluation of the level of threat was that external factors such as standards professional rules etc. outside the actions of the PPAP were affected. The proposed relocation of text on this procedures is questionable. In 320.5A3 it was the firm's compliance with quality control standards that may be a safeguard; thus a firm-driven action. We suggest the IESBA reconsider this particular revision proposal.

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

None.

Further Questions

In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:

a) *Small and Medium Practices (SMPs) and PAIBs – The IESBA invites comments regarding any aspect of the proposals from SMPs and PAIBs.*

600.7A4 is a significant paragraph and especially useful for SMEs whose audit clients may often turn to their auditor as a trusted and competent professional for advice. It would be helpful if this were more prominent placed, i.e., immediately following proposed R600.7.

The Safeguards project could have provided an opportunity for the Board to revisit certain issues with a view to enhancing clarity and considering the impact of practical application in certain areas. Indeed, during phase 1 of this project this was the IESBA's stated intent. However, the Code is becoming longer and the provisions increasingly rules-based. It is not apparent that the IESBA has been sensitive to the circumstances facing auditors and professional accountants serving the SME community in recent proposals including this project. In this context, we refer to specific comments elsewhere in this letter.

604.7A2 proposes as a safeguard that tax calculations should be undertaken by a tax professional that is not a team member (also in 604.10A2). In SMP the tax calculations will almost always be done by a team member because there are no special tax professionals (no tax department like in big audit firms) and the team member knows the client and how specific facts have to be treated specifically in the tax returns. If this safeguard is unavailable to smaller firms these will be at a disadvantage in the market. We believe that the Code could usefully recognize that the level of threat may be far lower in some such

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circumstances (e.g., where an SME is concerned tax may be far less complicated or subjective than in the case of a larger entity).

Sections 410.4.A2b and A3 and also certain further sections of the ED include proposed changes. Specifically these refer to increasing the client base of a partner or firm as a possible safeguard. This is likely to be impractical for some firms – a sole practitioner may be unable to easily change the client base, and where there are two or more partners, this might be possible if work is reassigned centrally by firm level. For firms this does not seem feasible.

b) *Regulators and Audit Oversight Bodies – The IESBA invites comments on the proposals from an enforcement perspective from members of the regulatory and audit oversight communities.*

N/A

c) *Developing Nations – Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular on any foreseeable difficulties in applying them in their environment.*

N/A

d) *Translations – Recognizing that many respondents may intend to translate the final changes for adoption in their own environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals*

Paragraph 38 of the explanatory memorandum refers to translation of the staff-prepared compilation of the restructured Code. We find per se an encouragement that translation should begin ahead of the finalization of any paper highly irregular in terms of due process. We are concerned that it may even imply a lack of openness on the part of IESBA to possible respondents' comments on projects still open for comment.