

21 March 2016

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.: Exposure Draft, Proposed Revisions Pertaining to Safeguards in the Code — Phase 1

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.

General Comments

General Support

In general we support the project and what it seeks to achieve as noted in para. 2 and 9 of the Explanatory Memorandum. We specifically support the intention to consider the need for alignment with ISA 220 issued by the IAASB noted in para. 2, although we suggest this not be confined to just this single Standard in Phase II (e.g., ISQC 1 and ISA 250 specifically need consideration, but this is a general issue). We note that consideration of both challenges faced by SMPCs and NAS will be given during Phase II and consideration of the need for additional guidance on threat evaluation for PIEs and non-PIEs will be deferred to future work.

We firmly support the IESBA working alongside the IAASB in their project on quality control at firm level, as possible revision of ISQC 1 is currently under discussion.

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

page 2/9 to the comment letter to the IESBA dated 21 March 2016

Use of the Third Party Test

We note that material in paragraph 100.7 of the extant Code has been used as a basis for the proposed definition of the term “reasonable and informed third party”. We believe that application guidance would be helpful to stress that hindsight cannot be taken into account, e.g., by a regulator inspecting an auditor’s work.

We are not convinced that a third party test is necessary in circumstances where the Code requires a PA to exercise professional judgment. If used in other circumstances, we would only support the application of this so-called third-party test as proposed in R120.4 A1 in relation to a determination of whether the accountant complies with the fundamental principles of the Code. However, we do not believe that additional third-party tests for specific matters are appropriate elsewhere in the Code beyond this.

Overlap with the IESBA’s Project to Restructure the Code

Delineating this project from the Structures Project that is running in parallel is extremely challenging for respondents. We have found it necessary to include certain remarks in regard to specific issues in this comment letter as well as our comment letter relating to the Structure Project.

We note the Board’s belief that the fundamental principles establish overarching objectives professional accountants are required to meet (Para 9(a)(i) Explanatory Memorandum). In our comment letter concerning the restructuring of the Code we intend to suggest this be recognized in the redrafting, such that the Code would contain a number of general objectives supported by more specific requirements. Indeed, in regard to the Safeguards Project, we suggest that instead of requirements in R120.3 and R300.2 an overarching objective should be set for the professional accountant to apply the conceptual framework. This would serve in combination with the requirement for professional accountants to make an overall assessment of whether or not the objective has been met, supported by the explicit requirements and application material advised by the CAG (see para. 16 EM). The advantage of such drafting is that compared to more general objectives, requirements can be more specific and thus expected actions are far clearer. Overly broad requirements such as those in R120.3 and R300.2 are difficult to apply in practice.

page 3/9 to the comment letter to the IESBA dated 21 March 2016

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

page 4/9 to the comment letter to the IESBA dated 21 March 2016

Appendix

Request for Specific Comments

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:*
 - (a) *Identifying threats;*
 - (b) *Evaluating threats;*
 - (c) *Addressing threats;*
 - (d) *Re-evaluating threats; and*
 - (e) *The overall assessment.**If not, why not?*

Identifying threats

We agree with the Board's conclusion that the listing and categories of threats in the extant Code do not need to be augmented.

The second sentence of R120.5 does not contain the term "shall" so as to be a clear requirement, but is a statement of fact explaining how the requirement is exercised. We suggest the Board clarify its intent (i.e., as a requirement or application material). In our view, it is important for the IESBA to clarify that the understanding shall be sufficient for the intended purpose.

Although we agree in principle to the proposed change in treatment of external measures (previously "*safeguards created by the profession or legislation,*" "*safeguards in the work environment,*" and "*safeguards implemented by the entity*"), that are continually present in a professional accountant's working environment, as they may potentially reduce or eliminate one or more particular threats, we believe the Code needs to provide further clarification.

In particular, whilst there may be a clear understanding by PAs and regulators alike as to the potential negation of threats by safeguards created by the profession or legislation in a particular jurisdiction, the impact of safeguards within the other two categories may require more subjective evaluation. In our view, clarification of documentation requirements pertaining to the identification (and non-identification) of threats in all such situations would be helpful.

page 5/9 to the comment letter to the IESBA dated 21 March 2016

Whilst we believe that it may not be necessary for a PA to document safeguards created by the profession or legislation in a particular jurisdiction to eliminate a threat, documentation would likely be appropriate in situations where a PA has taken account of safeguards in the work environment and safeguards implemented by the entity during identification.

Without such clarification the Code will be unclear as to whether the IESBA intends this change to mean that when such a measure eliminates a threat, the professional accountant will no longer be faced with a threat to identify and consequently would not be expected to evidence non-identification. In contrast, it appears clear that measures that serve to reduce a particular threat will require that the professional accountant identifies a threat prior to taking account of such measures in evaluating whether the threat is at an acceptable level or not. However, distinguishing between these two scenarios may not always be straightforward in practice, which in turn could impact the expectations e.g., of oversight authorities as to a professional accountant's actions (and thus potentially documentation thereof) in this context.

In our view, in executing this change in approach, the Board also ought to specify that the requirement to identify threats excludes both threats that are eliminated by "external" measures as well as threats rendered clearly trivial, since threats of such inconsequence cannot threaten compliance with the fundamental principles. Consequently, only a threat that is both not clearly trivial and only partly addressed by a safeguard would be identified and evaluated.

Evaluating threats

We refer to our comment above concerning the need for clarification in regard to clearly trivial threats.

Addressing threats

We suggest that R120.7 be revised. The possible actions in (a) and (b) address a threat when services are provided. It needs to be clear that these are not mutually exclusive actions, as they could be combined, where appropriate. These should be distinguished from the action taken under (c), since this is an action of last resort, where services are denied because the threat cannot otherwise be reduced.

Indeed, (c) fits better under 120.7 A1, which might then need to be elevated to a requirement. It needs to be clear that where no safeguards are available the professional accountant is required to decline or discontinue the service. The Board should, however, add recognition that this may not be possible, adding the term "unless precluded from so doing by law or regulation". In some

page 6/9 to the comment letter to the IESBA dated 21 March 2016

jurisdictions there may be legislation preventing an auditor from resigning, especially, but not limited to the public sector.

Re-evaluating threats

Whilst we agree with the Board's proposal to introduce a new requirement in R120.8, we do not support the proposed creation of a new section. This is over-engineering of the Code, and it suggests that a routine process is intended, which does not reflect the substance of the requirement. We suggest R120.8 be moved to the section on identifying threats.

In our view, 120.8 A2 should be revised so to become a clear conditional requirement, since it requires the professional accountant to act in the event that a new threat is identified.

The overall assessment

We agree with the proposed requirement in R120.9 for the professional accountant to make an overall assessment as to achievement of an objective – compliance with the fundamental principles (here we refer to our comments above).

We agree that such requirement is not needed for every section of the Code, but once in total, which constitutes a similar approach to that taken by the IAASB in ISA 200. 21 and 24.

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

Reasonable and informed third party

We refer to our comments in the accompanying letter.

Acceptable level

We agree that it is appropriate to include the extant definition of “acceptable level” in the section dealing with the evaluation of threats, and to revise this definition to avoid unnecessary repetition as proposed.

page 7/9 to the comment letter to the IESBA dated 21 March 2016

Proposed Revised Description of Safeguards

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

The proposed text in 120.7 A2 is an amended version of the description in the extant Code.

Extant Code 100.13: “Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level.”

Proposed 120.7 A2: “Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.”

We comment on the proposed change of wording from “may” to “effectively”. We presume that the change has been proposed because removing external measures from the definition means that the professional accountant ought to have sole control of safeguard actions, and that accordingly the IESBA seems to believe that the term “may” is therefore no longer appropriate. However, for a variety of reasons safeguards themselves may not be a “watertight” response to threats, and so we would challenge whether this change in emphasis within the definition itself is actually justified. In addition, we are concerned that the term “effectively” may not be sufficiently clear. In this context we believe that this term could be interpreted in two ways. It could mean “to all intents and purposes” i.e., in effect, or it could mean that the intended elimination or reduction of a threat was effective, i.e., objective met. We suggest the Board delete this term or otherwise clarify the intended meaning.

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 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?”*
- If not, why not?*

page 8/9 to the comment letter to the IESBA dated 21 March 2016

We agree with the IESBA's conclusion.

We refer to our response to q.1 in regard to the manner in which the Board has proposed to execute this change.

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?*

We refer to our general comments on the need to distinguish between objectives and requirements. Other than this, we agree with the Board's proposed approach, and comment specifically on the proposed section 300 as follows:

Identifying threats

We note that the examples of threats in section 300 largely mirror those in the extant Code, but that the word "firm" has been replaced by "professional accountant" in the context of issuing reports, and, in some instances, elsewhere. We would encourage the Board to consider where use of the term "firm or professional accountant" might be more appropriate, as in some jurisdictions reports may be issued in the name of the firm and in others in the name of an individual. In other cases similar considerations may be warranted e.g., besides an individual professional accountant, a firm might conceivably have a close business interest with a client, and we would encourage the Board to consider each example on a case by case basis.

In streamlining the examples of threats and safeguards, the Board is proposing that certain examples present in the extant Code not be included in section 300. Their deletion could be problematical if it were misinterpreted as implying these specific examples no longer pose a threat. Given that the Code is intended for global application, it should retain material relevant to jurisdictions where such circumstances may be more commonly encountered.

Evaluating threats

We suggest the wording of paragraphs 300.2 A2 and 300.2 A3 be revised. We do not believe that the level of threat per se can change according to the factors listed in these paragraphs; rather it is the perception as to a threat's *significance* and what might be viewed as an *acceptable* reduction that might change. We

page 9/9 to the comment letter to the IESBA dated 21 March 2016

suggest the Board clarify its intention in this context. This applies equally to 300.2 A5.

Request for General Comments

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) – The IESBA invites comments regarding the impact of the proposed changes for SMPs.*

Other than discussed above, we have not identified any specific issues.

We note that consideration of challenges faced by SMPs will be given during Phase II. In our opinion, these demand higher priority, especially given the significance of the SMP community globally.

- (b) 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.*

We do not comment on issues specific to developing nations.

- (c) Translations—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.*

We refer to our response to q. 3 concerning the potential for misunderstanding of the term “effectively” in 120.7 A2. We suggest the Board either use a different term or add clarification to ensure consistent interpretation in English and on translation.