

Supplement to Agenda Item 4-A

Safeguards Phase 2 – Further Consideration of Certain Comments on Phase 1

| | Respondent Comment | TF Response |
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| <i>Reasonable and informed third party (RITP)</i> | | |
| AOB | N/A | N/A |
| IFIAR | N/A | N/A |
| IOSCO | N/A | N/A |
| IRBA | From the consultation process, respondents indicated that certain sections in the Code may require a slightly different test. As such, in the future the Board may want to consider an investor perception test. | The Task Force does not believe that it would be appropriate to narrow the description of RITP to only investors as there are other stakeholders’ perspectives or interests that might be relevant. Accordingly, the concept of RITP is very broad and includes investors. See also the response to the UKFRC below. |
| NASBA | N/A | N/A |
| UKFRC | <p>We are pleased that the RITP is no longer described as a “hypothetical person” and that it is explicitly made clear that such a person does not need to be an accountant.</p> <p>However, it is now stated that the RITP “would possess the <u>relevant knowledge and experience</u> to understand and evaluate the appropriateness of the accountant’s conclusions in an impartial manner” (emphasis added) - this maintains a risk that the third party test will still be applied from the perspective of an accountant rather than the objective lens of the public in whose interests the professional accountant has a responsibility to act. This description risks insufficient regard being given to perception issues. For example, information available to the public may</p> | <p>Support noted.</p> <p>The agree-in-principle text (AIPT) states that:</p> <ul style="list-style-type: none"> • “When applying the conceptual framework, the professional accountant shall use the RITP party test.” • The RITP test is a consideration by <i>the professional accountant about whether the same conclusions would likely be reached by another party</i>. Such consideration is made <i>from the perspective of a reasonable and informed third party</i>, who weighs all the relevant facts and circumstances that the accountant knows, or |

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| <p>give rise to a perception that an auditor’s independence is compromised, and thereby a loss of confidence in the audit.</p> <p>Accordingly, we reiterate that the third party test should reflect the anticipated views of the public in whose interests the professional accountant has a responsibility to act, assuming that they are informed about the circumstances (e.g. about the nature of the threats and the nature of any safeguards) and on the assumption that they would be reasonable (i.e. rational, fair and moderate rather than extreme) in forming those views. Being “informed” should be considered in the general sense rather than suggesting a need for specific knowledge and experience.</p> | <p>could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third <u>party does not need to be an accountant, but would possess the relevant knowledge and experience, to understand and evaluate the appropriateness of the accountant’s conclusions in an impartial manner</u> (emphasis added).</p> <p>The Task Force agrees with the UKFRC that RITP should be applied from the perspective an objective third party and that the RITP does not need to be a PA. The Task Force continues to be of the view that is also shared by the IESBA that it is important for the Code to explain the characteristics of the RITP in a manner that clear, simple and not overly detailed.</p> <p>The Task Force notes that in developing the description of the characteristics of the RITP, the IESBA deliberated extensively about questions that had been raised by some respondents to Safeguards ED-1 and the CAG about who should perform the RITP test. The Task Force has revisited the IESBA’s decisions and continues to be of the view that:</p> <ul style="list-style-type: none">• The description of the RITP test in the AIPT is appropriate because it explicitly states that the test involves “... a consideration by the PA about whether the same conclusions would likely be reached by <u>another party...</u>”• It is important to explain the meaning of “informed” as used in the term RITP. While the RITP does not need to be another PA, and does not have to be knowledgeable about all the matters in the Code, the Task Force continues to be of the view that the RITP needs to have enough “business acumen” to understand the issues that PAs would be dealing with as part of their work and the public’s expectations of PAs more broadly (see AIPT which states the RITP “... <u>does not need to be an accountant, but would possess the relevant knowledge and experience, to understand and evaluate the appropriateness of the accountant’s conclusions</u>” |
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| | <p>We also suggest again that the reference to the third party be extended to read '<u>objective</u>, reasonable and informed third party', which would reflect the importance of the objectivity of the third party (i.e. one not influenced by interests that would conflict with the public interest) and would also align it with the term used in the 2014 EU Audit Regulation (EU 537/2014) and Directive (2014/43/EC). While the Basis for Agreement in Principle identified that such recommendations were made by respondents (although in our case mistakenly suggesting it was intended as an alternative to "hypothetical") it does not explain why the IESBA did not consider it appropriate. Aside from adding to the explanation of the appropriate characteristics of the third person, it would also prevent an unhelpful inconsistency with the legal requirements in the EU.</p> | <p><i>in an impartial manner</i>").</p> <p>The Task Force believes that the description of a RITP established in the AIPT:</p> <ul style="list-style-type: none">• Clarifies that the RITP is not a real person, but rather is a concept.• Is consistent with the description of "reasonable person" that is used by legal professionals.¹ <p>Because a RITP is not a real person, but rather a concept that needs to be applied by PAs, the Task Force believes that the additional guidance in the Code will help PAs further consider perception issues that are important to the proper application of the conceptual framework. Accordingly, the Task Force does not agree that the description "...risks insufficient regard being given to perception issues..."</p> <p>As noted above, in finalizing the AIPT the IESBA determined that it is important for the Code to explain the characteristics of the RITP in a manner that clear, simple and not overly detailed. In doing so, the IESBA considered the following:</p> <ul style="list-style-type: none">• "... a reasonable and informed third party, would possess sufficient knowledge and experience to <u>objectively</u> evaluate the appropriateness of the..."• "... reasonable and informed third party test involves a consideration by the professional accountant about whether an <u>objective</u> person who possesses skills... such test entails that <u>objective</u> person weighing all the relevant facts and circumstances that the professional accountant..."• "...in an impartial manner..." as noted above. <p>The IESBA determined that the latter was a clearer articulation of the</p> |
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¹ <http://legal-dictionary.thefreedictionary.com/The+Reasonable+Person>

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| | | characteristic of a RITP. The Task Force believes that the words “...impartial manner...” effectively means the same as “objective manner” and notes the IESBA’s preference for the former. |
| <i>Acceptable Level</i> | | |
| AOB | n/a | n/a |
| IFIAR | n/a | n/a |
| IOSCO | n/a | n/a |
| IRBA | n/a | n/a |
| NASBA | n/a | n/a |
| UKFRC | <p>In our response to the Phase 1 ED we supported the aim of expressing the requirement to eliminate or reduce threats “to an acceptable level” in an affirmative manner. However, as then, the continued use of the term “acceptable level” causes us concern for a number of reasons. Firstly, the term ‘acceptable’ is in plain usage a low bar – for example it is defined in Merriam-Webster’s dictionary as encompassing: “capable or worthy of being accepted”, “a compromise that is acceptable to both sides”, “welcome, pleasing” and “barely satisfactory or adequate”. It does not convey a sense of high standards and public interest. Secondly, the meaning of the term as it is used in the Code is distanced from the requirements that apply (that meaning being set out in the Conceptual Framework and Glossary). As a result, reading the requirements in isolation, the professional accountant could believe it implies a bar that is</p> | <p>Taking on the advice of its CAG, the IESBA agreed to the following revised description of acceptable level² in the AIPT:</p> <p>“An acceptable level is a level at which a professional accountant using the reasonable and informed third party test <u>would likely conclude</u> that the accountant complies with the fundamental principles.”</p> <p>The Task Force believes that describing the term in an affirmative manner in the body of the Code under its own subheading makes the important term “acceptable level” more prominent in the conceptual framework and the Code.</p> <p>The Task Force believes that the threshold established with the use of the word “likely” in the description of “acceptable level” is appropriate because the concept is not an absolute one.</p> |

² The glossary to the extant Code included the following description of acceptable level “A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.”

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| <p>at too low a level.</p> <p>We believe that the most direct and affirmative manner in which to express this bar is to include in the requirements that threats are to be eliminated or reduced “to a level at which the fundamental principles would not be compromised”. This would help ensure that the professional accountant focuses on ensuring that threats are eliminated or reduced to a level where the third party test would be passed. We believe this (implicit) link to the third party test would better accord with the expectations of stakeholders, better support their confidence in the professional accountant, and be more likely to anchor the professional accountant to those expectations when evaluating threats and safeguards.</p> <p>We disagree strongly with the revised definition in the Phase 2 ED of “acceptable level” as “a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles”. This has the effect of applying the third party test from the perspective of a professional accountant rather than from the perspective of the public in whose interests the professional accountant has a responsibility to act. We also reiterate our suggestion that it should be made clear that the third party test would only be passed when it is at least probable (i.e. more likely than not) rather than ‘likely’, that the [objective,] reasonable and informed third party would conclude that none of the fundamental principles had been compromised.</p> <p>We note that the Basis for Agreement in Principle identified that such recommendations had been given in relation to the “acceptable level” but the IESBA’s rationale for rejecting them is not clearly set out.</p> | |
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