

Non-assurance Services

Richard Fleck, Task Force Chair

Virtual Meeting

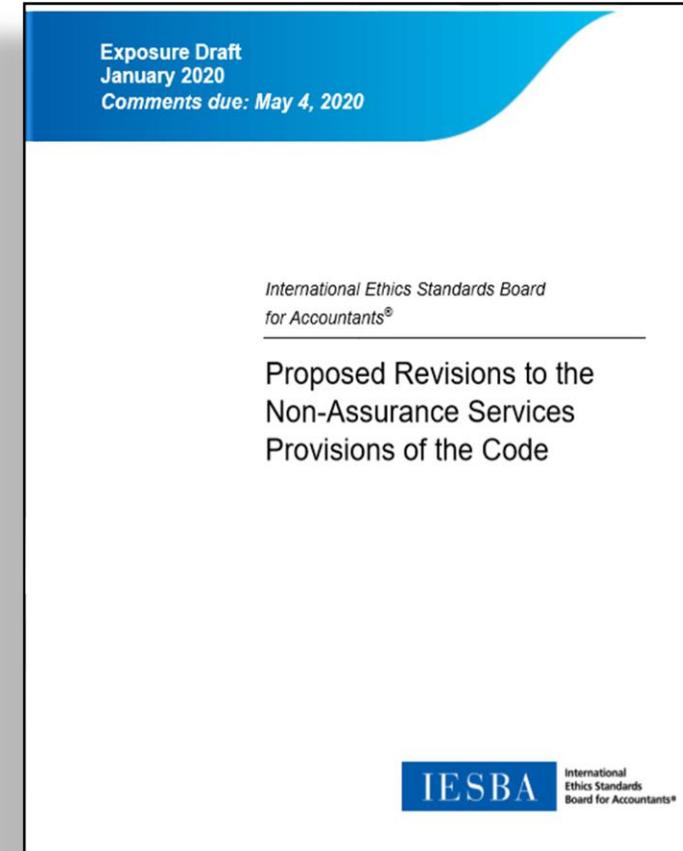
July 22, 2020

Objective

- To note observations and key issues raised by respondents to the NAS exposure draft
 - Views are preliminary and are subject to further refinement
 - Task Force met on June 22, 2020
 - IESBA to note significant themes and provide directional input on key areas

About NAS Exposure Draft

- Released in Jan; May 4, 2020 comment deadline
 - 12 questions for respondents
 - Mapping Table provided for comparison to extant Code NAS provisions
- Extension of comment deadline by a month due to COVID
 - About 26 letters received before deadline; most came in on final due date **June 4, 2020**



Overview of Respondents

| Category | # of Respondents |
|--|------------------|
| Regulators & oversight authorities, including MG | 9 (14%) |
| Public sector organizations | 3 (5%) |
| Preparers & TCWG | 2 (3%) |
| NSS | 5 (7%) |
| IFAC MBs & PAOs | 31 (46%) |
| Firms | 13 (20%) |
| Other | 3 (5%) |
| Total | 66 |

- Global organizations – **17**
- Asia-Pacific – **17**
- Europe – **15**
- Middle East & Africa – **9**
- North America – **6**
- South America – **2**
- ❖ **MG – IFIAR & IOSCO**
- ❖ **Certain IFAC MBs/ PAOs hold dual NSS role**

All comment letters available on [IESBA website](#)

General Comments

Overall support for project

- Calls for additional guidance in some areas; many suggestions provided

Some concerns re timing

- Still a priority even with COVID-19 pandemic?
- Wait until finalization of the PIE/ listed entity project?

- Some disagree with:
 - The focus on independence in appearance
 - The removal of **materiality** and the possibility of applying safeguards; viewed as deviating from Code's principles-based approach
- Some cautioned:
 - Against scoping in audit-related services
 - That PIE proposals will overtime impact non-PIEs
 - That the Code is being changed too frequently
- Questions about:
 - The effectiveness of safeguards that involve "...using a professional from the same firm..."
 - The definition of related entities

Prohibition on NAS that will create Self-review Threat (SRT) for Audits of PIEs

- Questions 1 & 2
 - Do you support SRT prohibition in ED-R600.14?
 - Does ED-600.11 A2 provide clear guidance to help consider whether the provision of a NAS will create a SRT?

Substantial support, including from regulators, NSS, firms and IFAC MBs

- Some call for stricter provisions
 - Why only SRT?
 - Should prohibition also apply to non-PIEs?
- Many suggestions to help enhance clarity

Those who do not support believe that “materiality” is a factor that should be considered

Providing Advice and Recommendations (A&R)

- Question 3

- Is the new AM related to providing A&R to audit clients, including in relation to tax advisory and tax planning clear and appropriate?

- General support for new AM; some concerns

- Queries about whether firms will be allowed to provide A&R that is:
 1. Required by laws and reg'ns
 2. A product of the audit (e.g., management letters and other output contemplated by auditing standards)
- Code should state that routine audit-related advice \neq A&R (threat is created from absence of management being able to make decisions based on the advice provided)
- The phrase “... *have a basis in tax law that is likely to prevail*” is considered subjective (preference for “... *is more likely than not to prevail*”)

Project on Definitions of Listed Entity and PIE

- Question 4

- Views about what the IESBA should consider in undertaking its project to review the definition of a PIE

- ❖ The most significant NAS proposals apply to PIE audit clients
- ❖ Should the forthcoming revisions to the definition of PIE come first?



Materiality

- Questions 5 & 6

- Do you support the proposals relating to materiality, including withdrawal of materiality considerations for audit clients that are PIEs?
- Do you support proposal to prohibit ...**tax planning/ advisory** and **corporate finance services** when the effectiveness of advice is dependent on a particular accounting treatment and the audit team has doubt...?

- Substantial support

- However, some respondents, especially SMPs object; they believe that:

- It is inappropriate to remove “materiality qualifier”
- In some cases, it might be possible to apply safeguards to address threats arising from the provision of NAS the outcome of which is immaterial
- The NAS engagement may be completed before the firm’s consideration of the accounting treatment

Communication with TCWG

- Question 7
 - Do you support the proposals for improved communication with TCWG, including the requirement to obtain concurrence from TCWG... ?
- Almost unanimous support
- Suggestion that proposals should also:
 - Apply to entities over which parent has control and which WILL be consolidated into the group f/s
 - Include a de minimis test
 - Include a documentation requirement
- Some believe that the proposal should apply to parent undertakings of unlisted PIEs

Other Comments (Q8 to Q12)

- Unanimous support for:
 - Relocating provisions relating to the assumption of management responsibility, including the related prohibition from S600 to S400
 - Elevating the extant AM relating to the provision of multiple NAS to the same audit client to a requirement; some requests for more guidance on how to assess the effect of such multiple NAS
- General support for more granularity in subsections that deal with specific types of NAS
 - Many suggestions to help enhance clarity and enforceability

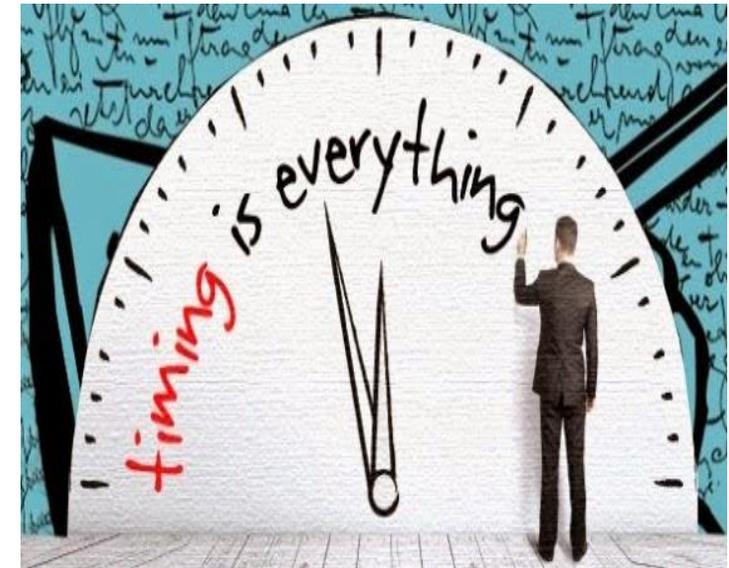
Issue A – Concerns about Timing

- Timeline for completion of NAS project should be extended to allow for:
 - Completion of the Definition of the PIE Project
 - Further understanding about how NAS proposals will affect SMPs
 - Exceptional circumstances arising from COVID-19
- Some respondents (e.g., AE, EFAA, SMPC) continue to question the pace and frequency of changes to the Code

Matter for IESBA Consideration

- The final revisions arising from the NAS, Fees and PIE projects should come into effect at the same time (e.g., Dec 2022?)
 - NAS & Fees to be approved in Dec 2020
 - PIE to be approved in Dec 2021
- Task Force considered **two** options
 1. Pause NAS project now and resume when PIE project is finalized
 2. Progress NAS project and establish the same effective dates for NAS, Fees and PIE revisions

Preference is for #2 – Stakeholders have generally support direction on NAS since 2018 roundtables; conforming changes arising from the PIE project to be dealt with before NAS revisions go into effect



Issue B – No Materiality ≠ Principles-based Code

- NAS proposals introduce additional prohibitions/ rules
 - Departure from principles-based “threats & safeguards” approach
 - Removal of “materiality qualifier” → Auditor’s/ firm’s professional judgment is not a deciding factor in determining whether a NAS will create a SRT

Task Force Reflections

- Code’s overarching provisions (i.e., Part 1) are principles-based
- Independence provisions include more specificity to help firms in applying the IIS in a consistent manner across jurisdictions

Matter for IESBA Consideration

- In finalizing ED, IESBA determined that materiality should not be a factor in deciding if a NAS will create a SRT for an audit client that is a PIE
 - In general, materiality is a factor in evaluating whether a threat to independence created by a NAS is at an acceptable level (ED-600.9 A2); however, for PIEs once the firm determines that a NAS will create a self-review threat, the SRT prohibition in ED-R600.14 applies
 - In the case of audit clients that are PIEs, self-review threats cannot be eliminated, and safeguards are not capable of being applied to reduce them to an acceptable level
- Task Force view is unchanged from ED position

Question for IESBA – Should the ED position on materiality be revisited?



Issue C – SRT Prohibition and Related Entities

- Consistent with the approach in extant Code, the SRT prohibition applies to related entities of listed entities (p. R400.20 and ED-R600.14)
 - This includes parent undertakings and only the controlled undertakings for other entities
- Some respondents, especially regulators raised questions
 - Does the SRT prohibition apply to parent undertakings that are unlisted entities?
 - Should a firm provide a NAS to an unlisted parent entity of a PIE without information being provided to/ and concurrence obtained from TCWG of the PIE?
- Task Force believes that these questions suggest a need to take a closer look at the Code's definition of related entities

Glossary Definition

Related entity

An entity that has any of the following relationships with the client:

- (a) An entity that has direct or indirect control over the client if the client is material to such entity;
- (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;
- (c) An entity over which the client has direct or indirect control;
- (d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and
- (e) An entity which is under common control with the client (a “sister entity”) if the sister entity and the client are both material to the entity that controls both the client and sister entity.

Section 400 Requirement & Definition of Audit Client

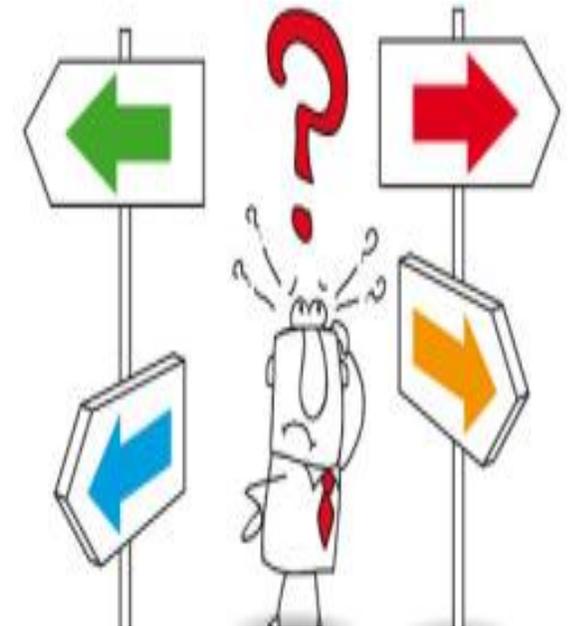
R400.20 As defined, an **audit client** that is a **listed entity** includes all of its **related entities**. For all other entities, references to an audit client in this Part include related entities over which the client has direct or indirect control. When the **audit team** knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the **firm's independence** from the client, the audit team shall include that related entity when identifying, evaluating and addressing **threats** to independence.

Audit client

An entity in respect of which a firm conducts an audit engagement. When the client is a listed entity, audit client will always include its related entities. When the audit client is not a listed entity, audit client includes those related entities over which the client has direct or indirect control. *(See also paragraph R400.20.)*

Matters for IESBA Consideration

- Task Force is of the view that the Code should indicate whether the SRT prohibition applies to related entities that are unlisted
 - However, doing so will first require revisiting the glossary definition of related entities vis a vis R400.20; and that will have implications for the IIS more broadly → Goes beyond the scope of NAS project
- There are **two** key questions for the IESBA to consider
 1. Which project Task Force should deal with the questions raised about related entities? --- ET/ Group Audit Independence? NAS? Fees? PIE?
 2. How should the questions about related entities be dealt with?



Issue D – Appropriateness of Safeguards

- IOSCO and IFIAR continue to challenge the adequacy of NAS safeguards that involve
 - “using professionals who are not audit team members to perform the service...”
 - “...having an appropriate reviewer ...review the audit work...”
- Strong view that the above are not sufficient safeguards
 - There is a view that the professional may be incentivized to make judgements that protect the economics and other interests of the firm rather than the public interest and needs of investors

Economics and Other interests of Firm Versus the Public Interest and Needs of Investors

- IESBA considered stakeholder concerns about the economics and other interests of the firm rather than the public interest and needs of investors in finalizing the Fees ED
 - New application material is included in the NAS ED to remind firms that the NAS fees is a relevant factor in identifying and evaluating NAS threats (see ED-600.9 A2)
 - The Code deals with self-interest threats to independence that arise from the fees in relation to the provision of a service to an audit client, including NAS fees in Section 410
 - Fees ED included proposed revisions to strengthen the Code's fee-related provisions with respect to fees paid by an audit client, including new guidance to assist firms in evaluating and addressing threats created by a high level of fees generated by the provision of audit services and services other than audit
 - For PIEs, the Fees ED also included proposals to improve firm communications about fees (including NAS fees) to TCWG and to the public → Enhanced transparency

Matters for IESBA Consideration

- The same comment was raised in 2017 in response to the IESBA's Safeguards Phase 2 ED; in finalizing the Safeguards project, IESBA
 - Added new AM to explain the importance of applying the conceptual framework in addressing threats and clarified that in some circumstances, safeguards may not be available
 - Clarified the characteristics of an appropriate reviewer
- IOSCO suggested that IESBA consider replacing the NAS safeguards with the examples of actions in ED-600.20 A1
 - Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary
 - Engaging another firm to evaluate the results of the NAS or having another firm re-perform the NAS to the extent necessary to enable the other firm to take responsibility for the service
- Others commented that such safeguards were unrealistic or impractical

Issue E – IESBA Code; Laws, Regulations & Auditing Standards

- Requests for clarification of the position where there is a conflict between the prohibition of the provision of NAS and provision in applicable laws, regulations and auditing standards; situations to be considered
 1. Where laws or regulations take a stricter position than the Code → addressed in R100.3/100.3 A1 clearly establish that the requirements in laws and regulations take precedence
 2. Where laws or regulations permit (but do not require) provision of a NAS that would be prohibited under the proposed revised provisions → addressed in 100.3 A1 which states that PAs "comply with the more stringent provisions unless prohibited by law or regulation"
 3. The position where the provision of A&R that create a SRT (and so would be prohibited) is contemplated by auditing standards e.g. management letters - which is not addressed in the Code deals with laws and regulations, but is silent about auditing standards

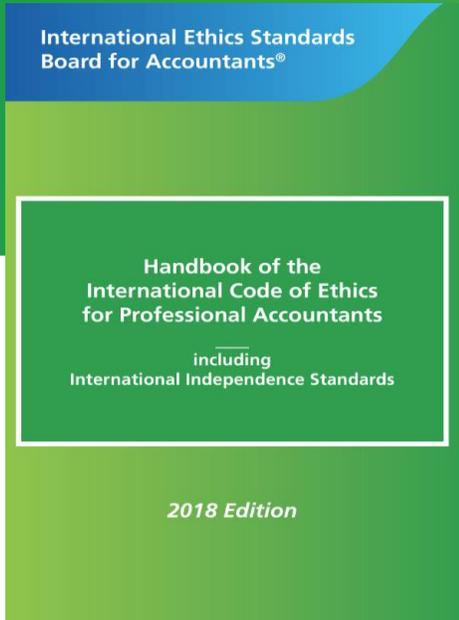
Current Thinking → Include a new paragraph to clarify that the provision of A&R that is contemplated in auditing standards is not prohibited by ED-R600.14.

Matters for Future IESBA Consideration

- Task Force to incorporate IESBA input and respondents drafting suggestions in revising proposed texts in ED
- Revisions are anticipated to:
 - Clarify how firms are to determine if a NAS will create a SRT
 - Clarify whether certain NAS safeguards continue to be appropriate (e.g., advocacy threats)

Next Steps

- **August 2020**
 - Task Force calls
 - Request IESBA input on certain provisions by email
- **September 2020**
 - CAG discussion
 - IESBA First-read
 - Targeted outreach – FOF, IFIAR, IOSCO, SMPC
- **December 2020**
 - Second-read
 - Approval of final text



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