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IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft: *Proposed Revisions to the Non-Assurance Services Provisions of the Code*

INTRODUCTION

The SMP Committee (SMPC) is pleased to respond to the IESBA (the Board) on this Exposure Draft (ED). The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMPC are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies representing 22 countries from all regions of the world.

GENERAL COMMENTS

The SMPC has been following the development of the project on Non-Assurance Services (NAS) since its inception and welcomes the close coordination of IESBA with the International Auditing and Assurance Standards Board (IAASB). We concur that the outcome from the work of the Task Force on the definition of Public Interest Entities (PIEs) and Listed Entities (the PIE Project) will have a significant impact on the proposed changes outlined in this ED and therefore support the PIE Project being accelerated. In light of the significant impact the definition of PIEs will have on this ED (and the Fees ED), it is our view that further work on the NAS and the Fees projects should be deferred pending a firmer idea or concept being in place from the outcome of the PIE Project as depending on the definition, it may influence our views on the various issues proposed in the Exposure Drafts.

While we agree with the IESBA that many of the proposals are aimed at maintaining public trust and confidence in the audit as they are intended to address public perceptions about auditors' independence, especially independence in appearance, on a certain spectrum of clients, the impact of such changes on the SMP market (those serving mostly smaller entities, including PIEs) has not been thoroughly quantified. In our view, paragraph 72 in the ED alluding to a possible increase in costs associated with the implementation of awareness and training initiatives, translation where needed and maintenance costs in updating firms' internal policies and methodologies has underestimated the actual impact of these proposed changes.

Furthermore, the no tolerance stance (i.e., outright removal of the materiality threshold) proposed by IESBA for PIEs (and, for some services, also applies to the non-PIEs) is based on the argument that perception of independence in appearance is key, whereas the IESBA's mechanism has been the application of the reasonable and informed third party test, which was designed for this purpose and is instead being overridden. A third-party test might not lead to the same outcome as a no stance approach in all cases as the former allows for flexibility. For the very largest/ publicly relevant PIEs a no tolerance stance could be the best result, but it may not necessarily be the case for all PIEs.

We believe the Board should consider the frequency of changes to the IESBA Code and consider the deferral of further changes. A persistent challenge of the SMP community based on our past SMP Surveys is keeping up with changes in laws and regulations. The 2018 restructured Code, which was effective as of June 2019, included substantive revisions and a new structure and drafting convention. The ED also indicates that further NAS

technology-related changes will commence in 2020. In addition, the Board should reflect on the significant impact of COVID-19, which is likely to be felt for an extended period of time. SMPs are seeing their own businesses being adversely affected but, being the trusted advisor to many SMEs, their resources are being strained to the point of breaking as they try to assist their clients to go through this period of great distress the likes of which is unprecedented in modern history.

In pursuing its ambition to ensure appropriate auditor independence (in appearance rather than actual), the IESBA must keep in mind the fact that services from many SMPs are generally of a high quality and there are synergies for the entities in consulting their auditors on some specific issues. Advantages for business entities are often the speed of support and the ability to provide bespoke solutions, usually at a lower cost. It would not be in the public interest for the NAS or fees project to lead to denial of key support and services in the aftermath of the current ongoing crisis. The auditor in the SMP knows the client's individual situation and circumstances well and is therefore best placed to provide tailor-made advice very quickly and efficiently – which is what is (and will be for some time to come) urgently needed at present throughout the world.

SPECIFIC COMMENTS

We have outlined our responses to each question (*in italics*) in the ED below.

1. Do you support the proposal to establish a self-review threat prohibition in proposed paragraph R600.14?

While we generally support the intention of the Board to emphasize the heightened concerns of a firm when dealing with PIEs, we have some reservations.

One of the main changes proposed is removing the so-called materiality threshold. The extant Code allows for safeguards to be put in place in some cases – the current proposals preclude all NAS to PIEs that create a self-review threat, regardless of whether this would be insignificant or immaterial. The removal of the materiality threshold in some ways undermines the fundamental premise of the Code, which relies on the identification of threats and safeguards, in order to mitigate or reduce threats to an acceptable level, therefore for SMPs who have PIE audit clients, the removal of the materiality threshold could be a key issue. A reasonable informed third party weighing up the facts and circumstances of an individual case might well concede that a no tolerance approach is excessive when factors, such as for example, the magnitude of an impact of a NAS on independence could be weighed up against the strength of possible safeguard(s). Furthermore, the focus on "independence in appearance" may not be appropriate in respect of all PIEs worldwide.

Similar with the ED on fees-related provisions, we would like to highlight that the issue being dealt with in this ED is one of perception and not independence in fact; hence a no tolerance approach is too rigid even for the PIEs segment.

More importantly, IESBA will need to revise the definition of PIEs to be fit for purpose. A blanket prohibition that is not scalable will result in entities unwittingly caught up in the revised definition of PIEs to be prejudiced by many of the proposed provisions as outlined in this ED and hence why we believe that further work on the NAS ED should be deferred pending the outcome of the PIE Project. We are also concerned that bans on the permissibility of NAS to audit clients that are PIEs may – over time – lead to a trickle-down effect, certainly as far as larger SMEs that are non-PIEs are concerned.

2. *Does the proposed application material in 600.11 A2 set out clearly the thought process to be undertaken when considering whether the provision of a NAS to an audit client will create a self-review threat? If not, what other factors should be considered?*

Yes, this paragraph does set up the thought process that should be undertaken when considering the provision of NAS to an audit client that may potentially create a self-review threat. However, we note that the extant Code includes materiality to the financial statements as a factor in determining the level of any potential threat. While this is retained under 600.9 A2, we question the need to delete this factor for PIEs, as well as on some of the NAS offered to non-PIE clients.

The criterion (b) of 600.11 A2 that states "the results of the service will be *subjected* to audit procedures" is also unclear and hence, should be further clarified.

3. *Is the proposed application material relating to providing advice and recommendations in proposed paragraph 600.12 A1, including with respect to tax advisory and tax planning in proposed paragraph 604.12 A2, sufficiently clear and appropriate, or is additional application material needed?*

While the proposed application material relating to the provision of advice and recommendations in proposed paragraph 600.12 A1 is sufficiently clear, we question if it is practicable to foresee the choice a client will make before agreeing to perform the service. It is akin to second guessing the client's decision without the necessary information to do so.

We also have further reservation on paragraphs R604.4 and 604.12 A2. Paragraph R604.4 states that "A firm or a network firm shall not …. unless that treatment has a basis in applicable law and regulation that is likely to prevail". Paragraph 604.12 A2 (c) also has the same wording. Our concern is that the suggested threshold may not work in some jurisdictions (e.g., Germany) due to (national) legal provisions. In any case, such a threshold may drive overly conservative tax services by practitioners worldwide and for all taxation markets. It also may set a precedent for the ongoing project on tax services (still in its fact-finding stage), and so should be deferred until that has been subjected to a fuller discussion.

4. *Having regard to the material in section I, D, "Project on Definitions of Listed Entity and PIE," and the planned scope and approach set out in the approved project proposal, please share your views about what you believe the IESBA should consider in undertaking its project to review the definition of a PIE.*

The SMPC agrees with the observations that it would not be an easy task to develop a single definition of PIE at a global level that can be consistently applied by all jurisdictions without modification and further refinement at the local level because there are different national definitions of PIEs at present. On the other hand, using the term "significant public interest entities" may be seen as "layering", ending up with diluting the importance of "only" PIEs and potentially opening up a new expectation gap as the term PIE is already well-known.

It is thus important for IESBA to clearly articulate the entities to which the specific provisions of the Code shall apply; otherwise some jurisdictions may include entities in their PIE definitions for which the IESBA provisions would be inappropriate/ impractical or just an overkill.

The approach to include several new categories in a broad manner, while at the same time allow national restrictions may be necessary but can also be confusing in practice and might lead to some unintended consequences and inconsistent application. Perhaps, the degree of public accountability can be a way forward.

However, as mentioned in Q1 above, the bigger issue is the fact that the NAS and fees-related projects have not been able to take into consideration the outcomes of the PIE Project. This has led to IESBA making proposals affecting all auditors who service PIE audit clients without knowing the full consequences. The uncertainty of the outcome of the PIE project is also likely to impact the ability of stakeholders to be able to provide complete input in response to this ED.

5. *Do you support the IESBA's proposals relating to materiality, including the proposal to withdraw the materiality qualifier in relation to certain NAS prohibitions for audit clients that are PIEs (see Section III, B "Materiality")?*

We do not support a blanket withdrawal. IESBA has not sufficiently evidenced its justification for making the significant change from the extant Code as proposed.

In our opinion, existing safeguards, such as the reasonable and informed third-party test and prior concurrence of TCWG would be adequate. Both of which would logically include due consideration of the magnitude (whether measured in terms of financial statement materiality or by other means) of the impact on independence of providing the particular NAS.

We would ask IESBA to consider further whether deleting materiality to deal with independence in appearance is appropriate for PIEs worldwide once it has clarification on the definition of PIEs within the Code.

6. *Do you support the proposal to prohibit the following NAS for all audit clients, irrespective of materiality:*

    - *Tax planning and tax advisory services provided to an audit client when the effectiveness of the tax advice is dependent on a particular accounting treatment or presentation and the audit team has doubt about the appropriateness of that treatment or presentation (see proposed paragraph R604.13)*

We are of the view that the no tolerance stance as proposed is too rigid and would like to urge the IESBA to re-consider this proposal. We have articulated our reasoning under Q1 above. Further by prohibiting NAS for all clients, the Code is at risk of becoming overly prescriptive, moving away from being principles based. This in itself creates a risk to the profession.

In addition, new proposal (paragraph R 604.19) allows an auditor of an audit client that is a PIE to perform a valuation for tax purposes when one of the two criteria listed are met, provided the valuation is further subjected to external review by a tax authority or other regulatory authority. In our view, a similar stance ought to be taken for certain other tax advisory services where there are tax laws available to govern the matters concerned. This will allow for consistency in application, at least in the general domain of the provision of tax services.

    - *Corporate finance services provided to an audit client when the effectiveness of such advice depends on a particular accounting treatment or presentation and the audit team has doubt about the appropriateness of that treatment or presentation (see proposed paragraph R610.6)?*

We do not support the strict prohibition based on our reasoning as articulated under Q1 above.

7. *Do you support the proposals for improved firm communication with TCWG (see proposed paragraphs R600.18 to 600.19 A1), including the requirement to obtain concurrence from TCWG for the provision of a NAS to an audit client that is a PIE (see proposed paragraph R600.19)?*

Yes, the SMPC supports the flexibility provided under the proposal when dealing with communications with TCWG. We believe such proposal will enhance the transparency and communication between firms and TCWG and should be considered as an effective safeguard for NAS in general.

8. *Do you support the proposal to move the provisions relating to assuming management responsibility from Section 600 to Section 400, and from Section 950 to Section 900?*

One of the overarching principles concerning independence is that a firm or a network must not assume a management responsibility for an audit client. Hence, moving the provisions from Section 600 to Section 400 will give them better prominence and the SMPC is in support of such a move.

9. *Do you support the proposal to elevate the extant application material relating to the provision of multiple NAS to the same audit client to a requirement (see proposed paragraph R600.10)? Is the related application material in paragraph 600.10 A1 helpful to implement the new requirement?*

The IESBA has proposed to expand the extant material on multiple NAS provided to the same client to deal with cumulative impact through paragraph R600.10. It is, however, still not clear how this is intended to work, especially in terms of evaluating how the level of threat is impacted and the need for additional safeguards where the previous safeguards being put in place are no longer effective. This problem could be exacerbated in a group audit environment. More guidance materials, perhaps outside the Code, would be helpful.

10. *Do you support the proposed revisions to subsections 601 to 610, including:*

- *The concluding paragraph relating to the provision of services that are "routine or mechanical" in proposed paragraph 601.4 A1?*

Yes, we agree with the concluding paragraph.

- *The withdrawal of the exemption in extant paragraph R601.7 that permits firms and network firms to provide accounting and bookkeeping services for divisions and related entities of a PIE if certain conditions are met?*

Yes, we agree with the position taken by IESBA.

- *The prohibition on the provision of a tax service or recommending a tax transaction if the service or transaction relates to marketing, planning or opining in favor of a tax treatment, and a significant purpose of the tax treatment or transaction is tax avoidance (see proposed paragraph R604.4)?*

We would fully support a prohibition for reasons of tax evasion as this is illegal. Tax avoidance, in many jurisdictions is legal – as long as it has a basis in applicable tax law and regulation. However, the need to ensure that "it is likely to prevail" may be challenging. Determining such a purpose will likely never be clear cut (it is a moral issue and highly subjective as well as being impacted by divergent cultural norms throughout the world) and may even contravene taxpayers rights to minimize their tax burdens within legal means. Ultimately such uncertainty may lead taxpayers to turn elsewhere for all tax services, which given the high standards of our profession, may be against rather than in the public interest.

- *The new provisions relating to acting as a witness in subsection 607, including the new prohibition relating to acting as an expert witness in proposed paragraph R607.6?*

Yes, we agree with the position taken by IESBA.

11. Do you support the proposed consequential amendments to Section 950?

Yes, we agree with the consequential amendments to Section 950.

12. Are there any other sections of the Code that warrant a conforming change as a result of the NAS project?

No further comments.

Other

The SMPC is concerned about the proposals to now prohibit a firm from accepting appointment as auditor of a PIE to which the firm or the network firm has provided a NAS prior to such appointment that would create a self-review threat (R400.32). Such situations do occur in practice and the new proposals may have an impact on concentration in the audit market. While we understand the proposed rationale, the possibility of engaging a professional accountant who is not a member of the firm or for the PIE to engage another firm to either evaluate the results of the NAS or to re-perform the NAS is highly impractical and, in our view, not necessarily warranted in all circumstances. As this would apply to all NAS (i.e., irrespective of magnitude or relevance), we urge the IESBA to consider other possible courses of action that could address such situations – possibly on a sliding scale depending on the severity of the situation. There is a risk that SMPs may likely suffer the most by being excluded from the PIE audit market should such proposals prevail.

CONCLUDING COMMENTS

We hope the IESBA finds this letter helpful in informing the Board's deliberations on the NAS provisions and its eventual impact on the Code. Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

Monica Foerster

Chair, SMP Committee