

## New & Proposed International Independence Standards

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A lot transpired at the November/December 2020 virtual meeting of the International Ethics Standards Board for Accountants (IESBA or Board). Among other things, the Board approved significant revisions to the [\*International Code of Ethics for Professional Accountants \(including International Independence Standards\)\*](#) (the Code), which are intended to strengthen the Code's independence provisions and heighten stakeholder confidence in the audit function. Amended provisions fall into two sections of [\*Part 4A of the Code, Independence for Audit and Review Engagements: Section 410, Fees\*](#), and [\*Section 600, Provision of Non-Assurance Services to an Audit Client\*](#). The Public Interest Oversight Board (PIOB), which oversees the IESBA, is scheduled to approve the revisions to the Code in April 2021. Subject to the PIOB's approval, the IESBA will release the final pronouncements, which will be accessible on the IESBA's website at [www.ethicsboard.org/standards-pronouncements](http://www.ethicsboard.org/standards-pronouncements).

The Board also agreed unanimously to expose proposed revisions to the definitions of "Public Interest Entity" and "Listed Entity," key elements in the Code that determine whether stricter independence requirements should apply to an entity's audit engagement.

This article highlights the IESBA's final and proposed changes to the Code.

### Non-assurance Services

The Board made numerous, comprehensive revisions to the provisions for non-assurance services (NAS) provided to audit clients, with the overall effect of making the independence provisions more stringent, especially for audits of public interest entities or "PIEs." For example, the revisions prohibit firms from providing any NAS that might create a self-review threat to independence to a PIE audit client, even when the results of the NAS are neither material to the financial statements nor form a significant part of the client's internal controls over financial reporting. To remove subjectivity and increase consistency in application, the Board removed qualifiers that allowed these NAS to be performed in certain circumstances despite the self-review threat. The Board also enhanced guidance designed to help firms identify self-review threats, clarified the evaluation of self-review and other threats, and added new and substantially expanded requirements for firm communications with those charged with governance (TCWG) about NAS. Other changes are largely structural or furnish additional clarification by providing greater specificity about such things as the likelihood of a self-review threat arising.

Substantive changes to Section 600 may be categorized as those pertaining to *all* audit engagements (which include financial statement review engagements) and those applicable to PIE audit engagements only. Significant substantive changes in each category follow:

### **All Audit Engagements**

*Evaluate risk of self-review threat (new requirement).* Before providing NAS to an audit client, a firm or network firm shall determine whether the provision of the NAS might create a self-review threat by evaluating whether there is a risk that the following conditions exist:

- The results of the NAS will form part of or affect the accounting records, internal controls over financial reporting, or financial statements on which the firm will express an opinion; *and*
- In performing that audit engagement, the audit team will evaluate or rely on the firm or network firm's judgments made or activities undertaken in performing the NAS.

*Multiple NAS (new/ expanded requirement).* When a firm or network firm provides multiple NAS to an audit client, the firm shall consider whether, in addition to the threats created by each service individually, the combined effect of such services creates or impacts threats to independence. (Note: This requirement aligns with provisions in the U.S. Government Accountability Office (GAO) and the American Institute of Certified Public Accountants (AICPA) independence rules.)

*Tax avoidance (new prohibition)* A new requirement prohibits the provision of tax services or transactions that involve advocating a particular tax treatment or transaction that the firm had initially developed for which the significant purpose is tax avoidance. Specifically, a firm or network firm shall not provide a tax service or recommend a transaction to an audit client if (i) the service or transaction relates to marketing, planning, or opining in favor of a tax treatment that the firm or network firm initially recommended and (ii) a significant purpose of the tax treatment or transaction is tax avoidance. However, the NAS may be permissible if the firm is confident that the proposed treatment has a basis in applicable tax law or regulation that is likely to prevail. (Note: This provision reflects a U.S. [Public Company Accounting Oversight Board \(PCAOB\) independence rule on aggressive or confidential tax transactions.](#))

*Recruiting services (expanded prohibition).* In providing recruiting services to an audit client, a firm or network firm should not recommend the person to be appointed or advise on the terms of employment, remuneration, or related benefits of a particular candidate who would hold a senior management position in the company or serve on the board of directors.

### **PIE Audit Engagements Only**

*Self-review threat (new prohibition).* A firm or network firm shall not provide NAS to a PIE audit client if the provision of that service might create a self-review threat in relation to the audit of the financial statements on which the firm will express an opinion. Among other NAS that might create self-review threats to independence, this includes:

- Accounting and bookkeeping services (excluding the preparation of statutory financial statements for a related entity meeting specific criteria, which is similar

to those required under independence rules of the U.S. Securities and Exchange Commission)

- Preparing tax calculations of current and deferred tax liabilities (or assets)

Some revisions provide greater specificity as to when NAS might create self-review threats, e.g., legal or tax planning services when there is a risk that the results of the services will affect the financial statements on which the firm will express an opinion.

*Accounting and bookkeeping services (new prohibition).* The Code no longer permits firms to perform accounting and bookkeeping services for certain related entities and divisions of a PIE audit client.

A firm or network firm may provide advice and recommendations to a PIE audit client if the firm does not assume a management responsibility and applies the conceptual framework to identify, evaluate, and address threats (in addition to self-review threats) to independence that might be created by the provision of that advice, e.g., a firm may provide advice on accounting policies or propose adjusting journal entries arising from the firm's audit findings.

*Expert witness (new prohibition).* A firm, network firm, or individual in the firm should not act as an expert witness for a PIE audit client, which creates an advocacy threat except under certain narrow circumstances (for example, a court appoints the firm to act as an expert witness in a matter involving a PIE audit client, in which case the firm's duty is to the court and not the audit client).

*Communications with those charged with governance (new and expanded requirements).* Before a firm or network firm provides NAS to certain entities within the PIE audit client's corporate structure, the firm should provide information to the PIE's governance body that enables them to make an informed assessment about the impact of the firm's performance of the NAS, including the proposed fee, on the firm's independence. To proceed with the NAS engagement, the PIE's governance body should concur with the firm's assessment that threats do not exist or are at an acceptable level.

*Advocacy role (new prohibition).* In some instances, serving in an advocacy role cannot be mitigated by safeguards, e.g., when a firm or network firm assists a PIE audit client in litigation before a tribunal or court.

## Fees

Section 410, Fees, of the Code addresses the impact of fees charged to an audit client that might create threats to compliance with the fundamental principles. Changes to section 410 include:

- recognition that when fees are negotiated with and paid by an audit client, this creates a self-interest threat and might create an intimidation threat to independence,
- a new prohibition precluding firms from allowing fees for NAS to influence the audit fee,
- new requirement relating to the proportion of NAS fee to the audit fee,
- new requirements relating to fee dependency, and
- requirements for sharing information about fees with TCWG and the public.

Substantive changes to Section 410 pertaining to all audit engagements, PIE audit engagements, and non-PIE audit engagements are highlighted below:

### **All Audit Engagements**

*Audit Fee (new prohibition).* A firm shall not allow fees for services other than audit (“non-audit services”), including NAS, to influence the audit fee. However, this provision does not preclude the firm from considering the cost savings that can be achieved as a result of experience derived from providing the non-audit services.

*Proportion of NAS fee to audit fee (new requirement).* Firms should evaluate whether possible self-interest or intimidation threats arise when a large proportion of fees charged by the firm or network firms to an audit client come from providing non-audit services. New application material provides factors to consider and a possible safeguard to counter the threat(s).

### **Non-PIE Audit Engagements**

*Fee dependency (new requirement).* When for five consecutive years, a firm’s total fees from a non-PIE audit client constitute more than 30 percent of the firm’s total fees, the firm shall determine whether either of the following actions might be a safeguard to reduce the threats to an acceptable level, and if so, apply that safeguard:

- (a) Engage a professional accountant (independent of the firm expressing the opinion on the financial statements) to perform a pre-issuance review of the fifth-year audit work (prior to release of the fifth-year audit opinion); or
- (b) Engage a professional accountant (independent of the firm expressing the opinion on the financial statements) or a professional body to review the fifth-year audit work (after release of the audit fifth-year audit opinion but before issuing the sixth-year audit opinion).

If the total fees continue to exceed 30 percent, the firm is required to determine in each succeeding year whether either of these actions continue to be a safeguard to address the threats, and if so, apply that safeguard.

### **PIE Audit Engagements**

*Fee dependency (new requirement).* When for each of two consecutive years the total fees from a PIE audit client represent more than 15 percent of the total fees received by the firm, the firm shall determine whether the following action might be a safeguard to reduce the threats created to an acceptable level, and if so, apply it:

- Engage a professional accountant (independent of the firm expressing the opinion on the financial statements) to perform a pre-issuance review that is consistent with the objective of an engagement quality review (prior to release of the second-year audit opinion).

If the fees continue to comprise more than 15 percent of the firm’s total fees for five consecutive years, the firm shall cease to be the auditor after issuing the audit opinion for the fifth year.

*Transparency of Information (new requirement).* The firm shall communicate in a timely manner with TCWG of a PIE audit client:

(a) the current year audit fee; and (b) whether the threats created by the level of the audit fees are at an acceptable level and any actions the firm has taken or proposes to take to reduce such threats to an acceptable level.

The firm shall also disclose to TCWG:

(a) fees charged during the period covered by the financial statements for the firm or a network firm's provision of non-audit services (including NAS) to the client or related entities that the client controls (either directly or indirectly); (b) any threat(s) the firm has identified regarding the proportion of such fees to the audit fee; and (c) whether threats are at an acceptable level, and if not, any actions the firm has or will take to reduce such threats to an acceptable level.

If total fees from a PIE audit client represent more than 15 percent of the total fees received by the firm, the firm shall communicate with TCWG:

(a) that fact and whether the situation is likely to continue; (b) safeguards applied to address the threats created; and (c) any proposal to continue as the auditor.

To enhance the transparency of the firm's relationship to the client that may be relevant to the client's stakeholders in evaluating independence, the firm shall be satisfied that the following information is publicly disclosed in a timely and accessible manner:

(a) current year audit fee; (b) fees charged during the period covered by the financial statements for the firm or network firm's provision of non-audit services, including fees from the client's controlled entities that are consolidated for financial reporting purposes and from the client's other controlled entities when the firm knows or has reason to believe that such fees are relevant to the evaluation of the firm's independence; and (c) if applicable, the fact that total fees received by the firm from the audit client represent more than 15 percent of the total fees received by the firm for two consecutive years, and the year that this situation first arose.

## Public Interest Entity (PIE) and Listed Entity

In January 2021, the IESBA released an Exposure Draft (ED), [\*Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code\*](#), for public comment. The overall goal was to re-assess the definition of PIE for purposes of identifying a class of entities to which more restrictive auditor independence requirements would apply. For example, stricter independence requirements generally apply to NAS, fees, and partner rotation (long association), so the impact of this defined term on the independence rules is significant.

The Board's approach to revise the [current PIE definition](#) would expand the categories of entities to be considered a PIE, look to local regulators and standard-setting bodies to refine the list based on local preferences and circumstances, and require firms to determine whether to treat additional entities as PIEs when assessing independence. A [new staff publication](#) provides

additional context and guidance designed to help local regulators and standard-setting bodies further refine the PIE definition in their jurisdictions.

The approach is summarized in this visual which appears in the ED:



The Board’s reexamination of PIE began with the question: *why define a class of entities that should be subject to additional independence requirements?* The answer appears in paragraph 18 of the ED:

18. Following deliberations, the IESBA agreed to the overarching objective as set out in proposed paragraphs 400.8 and 400.9 that encapsulates the following rationale:
  - There are types of entities for which there is significant public interest in their financial condition and hence their financial statements;
  - It is important, therefore, that there is public confidence in those financial statements. A major contributor to that confidence is in turn confidence in the audit of such financial statements; and
  - Confidence in such audits will be enhanced by additional independence requirements.

A summary of the proposed changes to the PIE definition in the Code follows:

### Public Interest Entity

As proposed, section 400.8 states that certain independence provisions in Part 4A (*Independence for Audit and Review Engagements*) are applicable only to the audits of PIEs and sets forth factors to consider in determining the level of public interest in an entity.

The factors are:

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- Nature of the business or activities
  - Whether the entity is subject to regulatory oversight designed to provide confidence that the entity will meet its financial obligations
  - Size of the entity
  - Importance of the entity to its industry sector
  - Number and nature of stakeholders
  - Potential systemic impact on other sectors and the economy as a whole in event of financial failure
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Proposed section 400.9 sets forth the overarching objective to identify entities whose financial statement audits should be subject to more stringent independence standards, reflecting significant public interest in the financial condition of these entities.

Proposed section R400.14 lays out the broad categories of PIE as follows:

#### **Public Interest Entities**

**R400.14** For the purposes of this Part, a firm shall treat an entity as a public interest entity when it falls within any of the following categories:

- (a)** A publicly traded entity;
- (b)** An entity one of whose main functions is to take deposits from the public;
- (c)** An entity one of whose main functions is to provide insurance to the public;
- (d)** An entity whose function is to provide post-employment benefits;
- (e)** An entity whose function is to act as a collective investment vehicle and which issues redeemable financial instruments to the public; or
- (f)** An entity specified as such by law or regulation to meet the objective set out in paragraph 400.9.

Taken together, these provide guidelines for local bodies and firms to apply in determining which entities – and in the case of firms, which *additional* entities – should be treated as PIEs.

*Local bodies.* The Board believes that bodies responsible for setting ethics standards for professional accountants are best placed to determine which types of entities should be treated as PIEs. The Board expects that local bodies will refine the Code’s broad list of PIEs as appropriate for use within their jurisdictions and local codes as part of the adoption and implementation process.

*Firms.* Firms must apply laws and regulations that provide more explicit definitions of the PIE categories than in section R400.14. Firms must also determine whether to treat additional entities or categories of entities as PIEs (the Code currently encourages firms to do so). The firm’s decision should consider whether a reasonable and informed third party would be likely to conclude such entities should be treated as PIEs. The proposal also requires firms to publicly disclose when an audit client has been treated as a PIE. The ED does not specify how or where the firm should disclose this information but is seeking comment on those specifics and the “pros” and “cons” of disclosing fee information to the public.

#### **Listed Entity**

The ED proposes replacing “Listed Entity” with the broader term, “Publicly Traded Entity” (item (a) in the list of PIE categories). The proposed definition appears below:

*Publicly traded entity: An entity that issues financial instruments that are transferrable and publicly traded.*

The Board intended to include more entities in the proposed definition, which is not confined to shares, stock, or debt traded only in formal exchanges but also encompasses those in second-tier markets or over-the-counter trading platforms.

## Closing

The Board expects to release the final NAS and fees pronouncements by the end of April 2021, after the PIOB has given final approval. The revised NAS and Fees provisions will be effective for audits and reviews of financial statements for periods beginning on or after December 15, 2022. Early adoption will be permitted.

As for transitioning, if a firm or network firm has entered into a NAS engagement with an audit client before December 15, 2022 and work has already commenced, the firm may continue that engagement under the Code's extant provisions until completed in accordance with the original engagement terms.

The comment deadline for the proposed revisions to the PIE and Listed Entity definitions is May 3, 2021; the Board hopes to approve the final PIE pronouncement in December 2021.

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