

### Report-back on March 2019 CAG Discussions in Relation to IESBA's NAS Project

This document includes extracts from the draft minutes of the March 2019 CAG meeting<sup>1</sup> and an indication of how the Task Force/IESBA has responded to CAG Representatives' comments.

| Matters Raised   | Task Force/ IESBA Response   |
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| KEY POLICY DECISION  |  |
| <p>Mr. Thompson referred to recent developments in the UK, highlighting that some firms are opting not to provide NAS to audit clients that are public interest entities (PIEs). He asked whether the proposed revisions arising from this project will catch up with that trend.</p>  | <p>Point noted.</p> <p>The Task Force has considered the recent developments in the UK and other jurisdictions; however, the Task Force is taking a global approach to enhancing the independence provisions on NAS in the Code.</p>   |
| <p>Mr. Hansen inquired whether the definition of PIE is in the scope of this project.</p> <p>Ms. Robert agreed with the Task Force's approach and concurred that the Definition of PIE project is very important.</p> <p>Mr. Dalkin suggested that entities from the public sector should be included in the notion of PIEs.</p> | <p>Mr. Fleck responded that although a review of the definition of PIE is not part of this project, he anticipated that the explanatory memorandum to the Exposure Draft would include an indication of the IESBA's intention to bring forward such a project. He pointed out that the aim would be to align the effective date of the changes to the definition of a PIE with the effective date of the changes to the NAS provisions.</p> <p>Mr. Fleck agreed with Mr. Dalkin's point, added that he was also of the view that the discussion on PIEs has to be wider than simply listed entities.</p> <p>See also paragraph 11 in <b>Agenda Item C</b>.</p> |

<sup>1</sup> The March 2019 CAG minutes will be approved during the September 2019 IESBA CAG meeting.

| Matters Raised  | Task Force/ IESBA Response  |
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| RETAINING A DIFFERENTIAL APPROACH TO PIE AND NON-PIE AUDIT CLIENTS  |   |
| <p>Mr. Yurdakul raised that the audit services provided are the same for PIE and non-PIE clients. However, based on the current proposals, the provision of NAS would be different according to whether or not the client is a PIE. He asked whether this is solely because of the public interest.</p> <p>Similarly, Mr. Pavas asked what the rationale is behind treating non-PIEs differently. He saw a contradiction in differentiating between PIEs and non-PIEs. He was of the view that NAS creating a self-review threat should be prohibited both for PIEs and non-PIEs.</p> | <p>Mr. Fleck explained that due to the lack of resources, small- and medium-sized entities (SMEs) often need guidance from their auditors. He noted that SMEs need this relationship with the auditor to be able to grow. Any limits to this relationship would adversely impact their growth and that would be against the public interest.</p> <p>Regarding the Task Force's approach see also paragraph 10 in <b>Agenda Item C</b>.</p>  |
| <p>Reflecting on Mr. Fleck's response, Mr. James raised caution that carving out non-PIE audit clients could be seen not only as benefiting the public interest and economic growth but also as benefiting accounting firms in terms of additional revenue.</p>   | <p>Point noted.</p> <p>The differential approach between PIEs and non-PIEs reflects a need for balance and proportionality – see further responses from Mr. Fleck and Dr. Thomadakis below.</p>   |
| <p>Mr. Fortin supported the Task Force's approach. He pointed out that the element of perception of independence is higher for PIEs, consequently the pragmatic approach is to have different provisions for them. He believes this issue is not about independence, because the Code still has provisions for non-PIE clients. However, the IESBA needs to keep the flexibility in that area as a matter of balance.</p>   | <p>Mr. Fleck concurred, noting that the conceptual framework still applies in the case of non-PIEs.</p> <p>Dr. Thomadakis remarked that PIEs are more exposed to public interest issues and therefore there is a different level of responsibility for firms with respect to them, a proportionality which is already reflected in the Code. However, he noted that this does not mean that there is no need for safeguards in case of non-PIE clients. His view was that this is a matter of graduation of intensity in applying safeguards and not the absence of provisions and safeguards for non-PIEs.</p> |
| <p>Reflecting on Dr. Thomadakis' remarks, Mr. James noted that in his view there is no such thing as graduation of independence, but perhaps graduation of services firms can provide. In case of audit clients, firms can be independent or not independent, and he felt the line should be drawn there.</p>   | <p>Dr. Thomadakis acknowledged the point but noted that even in the EU Audit Regulation, there is a focus on PIEs. He emphasized that the Code's conceptual framework applies fully to non-PIEs.</p>  |

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| <p>In line with the distinction between PIEs and non-PIEs, Mr. Yurdakul suggested that the Task Force consider the possible implications when a non-PIE client later becomes a PIE.</p>   | <p>Mr. Fleck responded that the Task Force is conscious of this transition issue.</p> <p>The Task Force is proposing amendments to the provisions of the Extant Code regarding the conditions under which firms can be independent after the firm or the network firm previously provided NAS to an audit client that later becomes a PIE. See paragraph R600.21 in <b>Agenda Item C1</b>.</p>   |
| <p>PROHIBITION OF NAS CREATING SELF-REVIEW THREAT</p>   |  |
| <p>Mr. James suggested reviewing the language of the requirement regarding considering prohibitions in national laws and regulations. He noted that it should be stronger than just “consider” relevant laws and regulations as compliance is needed.</p> | <p>Mr. Fleck responded that the Code already recognized the need for such compliance.</p> <p>Subsequently, the Task Force revisited its proposal, adding a reminder for firms to consider and apply the NAS provisions in laws and regulations, thereby emphasizing a requirement that is already set out in Part 1 of the Code. See paragraph 600.6 A1 in <b>Agenda Item C1</b>.</p> <p>In addition, the fundamental principle of professional behavior imposes an obligation on all firms to comply with relevant laws and regulations (paragraph R115.1 of the Code).</p> |
| <p>Ms. Pettersson and Mr. Hansen highlighted the need for further guidance regarding the concept of “direct and indirect effect on the financial statements” in the wording of the prohibition.</p>   | <p>Mr. Fleck responded that the Task Force will try to articulate how indirect effect operates in practice through some examples.</p> <p>Subsequently, The Task Force was asked by the Board to revisit the phrase “direct and indirect effect on the financial statements,” which was viewed as unclear or ambiguous.</p> <p>The prohibition is now worded directly in terms of a “self-review threat” – see paragraphs 12-15 in <b>Agenda Item C</b>.</p>  |

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| <p>In relation to the proposed list of examples to prohibited services due to the self-review threat included in the application material, Dr. Lawal noted that the list could be good guidance. Messrs. Pavas, Hansen and Fortin concurred.</p> <p>Ms. McGeachy-Colby noted that it was helpful to have the list of prohibited services. However, she suggested that it would be helpful if there were a staff publication explaining what the safeguards might be if there was no prohibitions.</p> <p>On the other hand, Ms. Borgerth was of the view that a list of such services could result in an undue focus on them at the expense of firms carefully thinking about the particular NAS to be provided.</p> | <p>Points taken into account</p> <p>Responsive to IESBA members' views, subsequently the Task Force decided to delete the list of examples to prohibited services that create a self-review threat.</p>  |
| <p>Mr. Yurdakul noted that the outcome of the NAS could impact the financial statements several years down the road.</p>   | <p>Point taken into account. During the meeting Mr. Fleck responded that the Task Force would consider the matter further.</p> <p>The Task Force proposes a requirement to clarify the conditions under which a firm or network firm can accept an engagement to be an independent auditor for an entity where that firm or network firm previously provided a prohibited NAS to the entity. See paragraphs R400.32 in <b>Agenda Item C1</b>.</p> <p>In addition, the definition of a self-review threat is not time-restricted.</p> |
| <p>As to the issue of materiality, Messrs. Dalkin and James supported the withdrawal of the concept of materiality with respect to the provision of NAS where a self-review threat arises.</p>   | <p>Support noted.</p> <p>Regarding the Task Force's updated approach to materiality as a "qualifier" for PIEs and non-PIEs, see also paragraphs 26-31 in <b>Agenda Item C</b>.</p>   |

| Matters Raised   | Task Force/ IESBA Response  |
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| PROVISION OF NAS CREATING OTHER THREATS  |   |
| <p>Mr. Dalkin asked how the “significance of a threat” should be interpreted. He noted that in the US, the GAO has adopted the IESBA’s conceptual framework but added guidance to explain what “significance” means. He raised the same question with respect to the interpretation of the term “acceptable level.” He did not suggest moving away from the principles-based approach. However, he suggested considering providing some specificity but acknowledged the danger of ending up with rules.</p>   | <p>During the meeting Mr. Fleck responded that the Task Force injected into the thought process the reasonable and informed third party test (RITP test) and indicated that this issue is on the radar screen of the Task Force.</p> <p>The Task Force is proposing new application material in Section 600 relating to evaluating threats with respect to NAS. This new application material emphasizes the importance of using the RITP test in applying the conceptual framework to independence. See paragraph 10 in <b>Agenda Item C</b>.</p>  |
| <p>Mr. James asked whether, in the thinking process suggested by the Task Force regarding the permissibility of an NAS, there was a point at which the firm considers the totality of the NAS provided to a client.</p>  | <p>During the meeting, Mr. Fleck responded that although the effect of providing multiple NAS to the same client is not part of the decision tree, the Task Force was proposing enhanced provisions regarding that matter.</p> <p>The Task Force is proposing elevating the application material in the extant Code relating to the combined effect of threats created by providing multiple NAS to the same audit client to a requirement. See paragraph R600.12 in <b>Agenda Item C1</b>.</p>   |
| PROHIBITION ON ASSUMING MANAGEMENT RESPONSIBILITY  |   |
| <p>Reflecting on Mr. Dalkin’s comments on the interpretation of “significance of a threat,” Mr. Hansen referred to the same problematic interpretation issue with assuming management responsibility. He noted that even though providing advice and recommendation is not considered as assuming management responsibility, at the end of the day management will act according to the advice provided.</p> <p>Mr. Dalkin agreed that the responsibility of management is subject to interpretation. He suggested that the IESBA consider providing guidance regarding that responsibility.</p> | <p>Points taken into account.</p> <p>During the meeting Mr. Fleck responded that the Task Force had recognized the question and tried to address it in the Code through focusing on the need for there to be suitable expertise within the client to understand the advice.</p> <p>Regarding the Task Force’s revised proposals relating to prohibition on assuming management responsibility and to providing advice and recommendation, see paragraph 19 in <b>Agenda Item C</b>.</p> <p>The extant Code already contains guidance on assuming management responsibility. This is reflected in paragraphs 400.13 A1 – 400.13 A4 in <b>Agenda Item C1</b>.</p> |

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| PRE-APPROVAL OF PROVISION OF NAS BY TCWG  |   |
| <p>Ms. Zietsman asked whether the Task Force had addressed the need for engagement by those charged with governance (TCWG) in the decision to avoid the request for an approval be a simple presentation of the NAS to TCWG.</p>                  | <p>Mr. Fleck confirmed that communication and pre-approval are intended to be an interactive two-way process between the auditor and TCWG.</p> <p>Regarding the Task Force’s proposals to improve firm communication with TCWG about NAS matters with respect to audits of PIEs, see paragraph 20 in <b>Agenda Item C</b>.</p>  |
| <p>Mr. Fortin noted that pre-approval would be better if it were a communication between TCWG and management, instead of with the auditor. He felt that for the auditor to ask TCWG could be problematic as it is more a management decision.</p> | <p>Mr. Fleck responded that both routes have their risks as many among management believe that having the auditor provide the NAS helps with the audit. He added that auditors should not avoid assessing the threats just because of pre-approval. He clarified that the aim of the proposal on enhanced communication is to ensure, through creating an environment where honest conversation can take place, that TCWG consider the NAS to be provided properly.</p> |
| <p>Mr. Pavas pointed out that the corporate governance environment for non-PIE clients is not appropriate for seeking pre-approval. He was of the view that in the case of such entities, it is not necessary.</p>                                | <p>Point taken into account.</p> <p>The Task Force revisited its proposals and agreed not to explicitly encourage pre-approval of provision of NAS in case of non-PIE audit clients.</p> <p>Regarding the Task Force’s updated proposals to improve firm communication with TCWG about NAS matters with respect to audits of non-PIEs, see paragraph 21 in <b>Agenda Item C</b>.</p>  |
| <p>Mr. Hansen raised the importance of the documentation of that pre-approval either by the entity or by the firm.</p>  | <p>Point taken into account.</p> <p>With regard to the process for pre-approval and how the pre-approval should be evidenced, the Task Force is proposing that the firm and TCWG agree on the process by which concurrence from the latter can be obtained (e.g., whether using an automated process that leverages technology or via manual means). See also paragraph 20 in <b>Agenda Item C</b>.</p>   |

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| EXCEPTION TO RELATED ENTITIES  |   |
| <p>Mr. Dalkin agreed with the Task Force’s proposals that parent companies should be out of scope of the exception provided to related entities.</p> <p>Mr. Fortin agreed but recognized it might be complicated to apply in practice.</p> | <p>Support and suggestion noted.</p> <p>After careful deliberation, the Task Force agreed that the Code should continue to retain the exemptions in paragraph R600.10 of the extant Code to preserve the existing alignment with the US SEC Rules.</p> <p>The Task Force does not believe that the provisions would be more complicated to apply in practice than some of the other independence requirements in the Code.</p>  |
| <p>Mr. Hansen also expressed support for scoping out parent entities; however, he also suggested excluding sister entities.</p>  |   |
| OTHER MATTERS  |   |
| <p>Mr. Fortin asked whether the issue of the period during which independence is required could be handled by auditing standards.</p>  | <p>Point not accepted.</p> <p>Insofar as international standards are concerned, setting independence requirements is outside the IAASB’s remit.</p> <p>The extant code already includes provisions relating to the period during which independence is required in section 400 (paragraphs R400.30 – 400.31 A2). The Task Force is proposing further enhancement to those provisions or clarify the conditions under which a firm or network firm can accept an engagement to be an independent auditor for an entity where that firm or network firm previously provided a prohibited NAS to the entity. See paragraph R400.32 in <b>Agenda Item C1</b>.</p> |
| <p>Mr. James inquired whether the project focuses on NAS provided to audit clients only or also assurance clients.</p>   | <p>Ms. Jules clarified that the project focuses on audit and review engagements, but consequential changes will be considered with respect to assurance clients in Part 4B of the Code.</p> <p>The proposed conforming amendments to Part 4B arising from the NAS Project are included in Appendix 2 of <b>Agenda Item C</b>.</p>   |