Meeting: IESBA CAG Meeting
Meeting Location: New York
Meeting Date: March 5, 2018

Non-assurance Services

Objectives
1. To obtain Representatives’ input on the Task Force’s planned approach and timing for the non-assurance services initiative.

Introduction
2. In December 2017, the IESBA established a Working Group (WG) to respond to concerns about the independence provisions in the Code\textsuperscript{1} applicable to the provision of non-assurance services (NAS) to audit or assurance clients.
3. This paper summarizes the issues identified by stakeholders, and the WG’s preliminary views about how those issues might be analyzed, prioritized and dealt with as part of a potential project.
4. The WG has determined that its analysis should include stakeholder engagement about specific issues.
5. The paper is organized as follows:
   - Summary of WG observations to-date;
   - Background;
   - Overview of planned fact-finding activities;
   - Issues identified;
   - WG views and observations;
   - Planned approach to roundtables; and

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\textsuperscript{1} The references to the “Code” in this paper are to the \textit{restructured Code} titled \textit{International Code of Ethics for Professional Accountants (including International Independence Standards)}. The IESBA approved the restructured Code in December 2017 and it comprises:
- Structural and drafting enhancements developed under the Structure of the Code project;
- Revisions to the provisions pertaining to safeguards in the Code, developed under the Safeguards project;
- Revisions to clarify the applicability of the provisions in Part C of the extant Code to professional accountants in public practice, developed under the Applicability project; and
- New application material relating to professional skepticism and professional judgment, developed under the Professional Skepticism (short-term) project.

Additional information about the restructured Code, including its effective date is available at: \textit{www.ethicsboard.org/restructured-code}.
Summary of WG Observations To-Date

6. The WG has identified the following issues of principle in relation to which it wishes to obtain views from stakeholders:

   - When considering whether it would be appropriate to provide NAS to an audit or assurance client, should firms and network firms be allowed to take into account whether a potential threat is material or significant?
   - When developing provisions in the Code to govern the provision of NAS to audit or assurance clients, should a distinction be drawn between those audit or assurance clients which are public interest entities (PIEs), as compared with those that are not PIEs?
   - Should the Code contain provisions governing the nature and extent of auditor communications with those charged with governance (TCWG) about NAS (e.g., pre-approval of NAS or disclosure to TCWG of NAS)?
   - Should the Code contain provisions establishing limits and disclosure requirements in relation to the amount of fees charged for NAS and the percentage of NAS fees versus audit fees?

7. The WG has also determined that it will be necessary to consider whether the IESBA should seek to align the NAS provisions in the Code with the NAS provisions in the local codes, laws and regulations (i.e., local ethics requirements) of the G-20 jurisdictions. In considering this issue, the WG will be seeking to understand:

   - The extent to which there are common elements to the NAS provisions in the Code and those in local ethics requirements.
   - Where there are differences in the NAS provisions reviewed, the rationale for those differences. For example, the WG will seek to determine whether there are legal, regulatory or other circumstances at the jurisdiction level that necessitate the level of specificity and prescriptiveness of NAS prohibitions across the G-20 jurisdictions.

8. The WG believes that it should take steps to obtain the views of key stakeholders on the issues identified in paragraphs 5-6 above. Accordingly, as part of its fact-finding activities, the WG is planning to host a series of global roundtables in conjunction with the Professional Skepticism WG. Subject to securing meeting venues, it is envisaged that there will be roundtables during the June-July 2018 time period in Asia, Europe and North America.

9. The WG intends to provide a briefing paper to all roundtable meeting participants in advance of the particular meeting. That briefing paper will be based on this Board paper.
Background

2013 NAS Benchmarking

10. In 2013, the IESBA undertook a “benchmarking” exercise focused on G-20 countries and a select number of other jurisdictions. Based on the results of that benchmarking exercise the IESBA concluded that:
   • Most jurisdictions have similar provisions.
   • There was no evidence that the Code’s NAS provisions as of 2013 were at significant variance from those of most or all of these jurisdictions.
   • Where jurisdictions had NAS provisions that were more restrictive than the Code, this was to respond to local ethics requirements.

2015 NAS Changes

11. Coinciding with its 2013 benchmarking, and in response to stakeholder feedback on its 2014-2016 Strategy Review Survey, the IESBA undertook a NAS project to revise certain independence provisions in the Code pertaining to the provision of NAS to audit or assurance clients. This project was completed in January 2015 and was intentionally limited in scope in order to timely deliver the revisions into the marketplace. The Basis for Conclusions includes information about the background to the 2015 NAS project and summarizes the IESBA’s rationale for its decisions. The main changes arising from the 2015 NAS project related to:
   • The removal of provisions that permitted a firm to provide certain bookkeeping and taxation services to PIE audit or assurance clients in emergency situations.
   • The establishment of new and clarified provisions regarding what constitutes management responsibility.
   • Revised and clearer provisions regarding the concept of “routine or mechanical” services relating to the preparation of accounting records and financial statements for audit or assurance clients that are not PIEs.

PIOB Request and Other Developments

12. In approving the 2015 NAS changes to the extant Code, the PIOB called on the IESBA to revisit issues on auditor independence from a broader perspective, including prohibited NAS and the role of TCWG in approving NAS.

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2 The term “benchmarking” is used to describe a process by which the IESBA:
   • Administered surveys requesting information about PIE and non-PIE local ethics requirements pertaining to NAS of 26 jurisdictions.
   • Analyzed the responses to the survey with a view to determining whether certain local ethics requirements relating to NAS are more restrictive than those in the Code.

3 See Agenda Items 5, 5A and 5B to the June 2013 IESBA meeting and the related IESBA meeting minutes.

4 See IOSCO’s Committee on Issuer Accounting, Audit and Disclosure (Committee 1) letter dated May 2, 2013 to the IESBA in response to the IESBA’s 2014-2016 Strategic Review Survey.
13. The following developments have also contributed to the need to update the IESBA's 2013 benchmarking exercise in 2018:
   - Certain regions and jurisdictions have established new laws and regulations with significant, and new, NAS provisions (e.g., 2014 EU Audit Reform Regulation and Directive).
   - Stakeholders, including respondents\(^5\) to the Safeguards exposure drafts (EDs), have made specific suggestions identifying those areas in the NAS provisions in the Code that they believe should be more restrictive. A further discussion of those stakeholders’ comments is included below in the section of the paper titled, “Issues about NAS Provisions Relating to Permissibility of NAS.”
   - Revisions have been made to the NAS provisions in the IESBA code as a result of the:
     o 2015 NAS project summarized above; and
     o The completion of the Structure of the Code and Safeguards projects, the final text of which forms part of the Code.\(^6\)
   - As part of a Fees Questionnaire with a response deadline of March 1, 2018, the IESBA is seeking input from stakeholders about the whether there is a relationship between threats to independence and fees charged for NAS provided to audit or assurance clients.

14. In discussing its proposals in Safeguards ED-2, the IESBA considered concerns that were identified about the permissibility of NAS, in particular from the PIOB and regulators during its finalization of the 2015 NAS changes. At that time, the IESBA agreed to address those concerns as part of a separate NAS initiative. That commitment was referred to in the April 2017 IESBA Strategy Survey Questionnaire (the IESBA Survey).

15. Respondents to the IESBA survey supported IESBA's intention to consider the concerns that had been identified. Further, during IESBA's discussions with its Consultative Advisory Group (CAG) about the feedback on the Safeguards EDs, the CAG expressed strong support for progressing this NAS initiative.

**Overview of Planned Fact-finding Activities**

16. To define the parameters and scope of a future NAS project, the WG plans to:
   - **Review and analyze those issues** raised by stakeholders about the NAS prohibitions in the Code that were beyond the scope of the Safeguards project.
   - Identify and understand any **differences** between the NAS provisions in the Code and the local ethics requirements in the G-20 jurisdictions.
   - Undertake **stakeholder outreach** to further understand specific views and perspectives of key stakeholders from specific categories and jurisdictions. In this regard, the WG is planning to host global roundtables and is planning to invite participants that represent investors and other users of financial statements, regulators and audit oversight authorities, firms, the corporate governance community, preparers, national standard setters, IFAC member bodies, academics and others.

\(^5\) Regulators: AOB, IFIAR, IOSCO, IRBA, UKFRC.

\(^6\) See footnote 1 of this paper.
• Take into account the relevant responses to the November 2017 IESBA Fees Questionnaire and the final recommendations of the Fees WG.

17. The WG’s planned timetable is discussed in the section titled “Planned Timeline.”

Issues Identified

Recap of Safeguards Project

18. The Safeguards project resulted in a significant enhancement to the NAS provisions in the extant Code. However, the focus of the project was on clarifying the application of safeguards in the Code and was not intended to deal with the permissibility of NAS. Among others, the revisions arising from the Safeguards project:

• Clarified how firms and network firms should apply the enhanced conceptual framework to identify, evaluate and address threats to independence created by providing NAS to audit or assurance clients.
• Clarified that safeguards may not always be available or capable of addressing threats that are created by providing a NAS to an audit or assurance client. In that case, the firm or network firm would be required to address those threats either by:
  o Eliminating the circumstances, including interests or relationships, that are creating the threats; or
  o Declining or ending the specific professional activity.
• Refined the examples of actions that might be safeguards to address threats created by providing NAS to audit or assurance clients by improving the linkage between the examples of safeguards and the specific threat(s) to which they are intended to respond.
• Extended the requirement to prohibit certain types of recruiting services to all entities (see paragraph R609.4).

19. The NAS provisions in the Code are included in Sections 600\(^7\) and 950.\(^8\)

Issues about NAS Provisions Relating to Permissibility

20. Various stakeholders have expressed views about matter that they believe should be affect the permissibility of NAS generally.

21. In relation to the overarching principles and conditions that affect the permissibility of certain NAS, some respondents:

  o Noted that advancing technologies and new business models may give rise to new NAS that are not specifically addressed in the Code or other local ethics requirements.
  o Questioned the IESBA’s rationale of prohibiting a NAS to an audit client that is a PIE, while permitting firms and network firms to provide the same NAS to audit or assurance clients that are not PIEs. Those respondents believed that no distinction should be drawn between audit

\(^7\) Part 4A – Independence for Audits and Reviews, Section 600, Provision of Non-assurance Services to an Audit Client
\(^8\) Part 4B – Independence for Other Assurance Engagements Other than Audit and Review Engagement, Section 950, Provision of Non-assurance Services to Assurance Clients Other than Audit and Review Engagement Clients
or assurance clients that are PIEs and those that are not and that, therefore, for all companies, the approach should be the same.

- Questioned the rationale for using the concepts of materiality and significance as a threshold for determining permissibility of providing NAS. They suggested that, if this approach is to be retained, the IESBA should provide additional guidance to assist firms and network firms determine when a NAS is material or significant. Others pointed out that local ethics requirements in some jurisdictions do not use a "materiality test" to determine whether or not a NAS should be permitted, and questioned why the IESBA should not adopt the same approach.

- Believed that when an auditor promotes or advocates a matter or position on behalf of a client, the auditor’s objectivity is potentially compromised because, in their view, the auditor will be biased (or will be perceived to be biased) to advance the client’s interests. Those respondents believed that the existence of an advocacy threat would exist irrespective of whether the amounts involved are immaterial and questioned whether the Code should continue to permit the provision of those NAS.

22. Some respondents to the Safeguards EDs suggested that the Code should be more closely aligned with the NAS provisions in the local ethics requirements in their jurisdictions (e.g., in Europe with the EU Audit Regulation), in relation to the provision of:

- Bookkeeping and preparing accounting records and financial statements, including those NAS of a routine or mechanic nature provided to divisions or related entities;  

- Designing and implementing internal control or risk management procedures;  

- Services related to the audited entity’s internal audit function; and  

- Services linked to the financing, capital structure and allocation, and investment strategy.  

- Litigation support services for PIEs when it is used for the purpose of advancing the entity’s interest in a legal proceeding or investigation with respect to amounts that are material to the financial statements subject to audit or review.

23. Questions have been raised about whether the provisions relating to NAS in the Code should:

- Include more “bright-line” rules to prohibit firms and network firms from providing certain types of NAS to their audit or assurance clients.

- Be strengthened in relation to the communications auditors have with TCWG about NAS. For

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9 Regulators: AOB, IFIAR, IOSCO, IRBA, UKFRC
10 Regulators: AOB, IFIAR, IOSCO, IRBA, UKFRC
11 Regulators: UKFRC
12 Regulators: UKFRC
13 Regulators: UKFRC
14 Firms: MNP
15 Consistent to the extant, the Code also encourages regular communication between the firm and TCWG regarding relationships and other matters that might reasonably bear on independence. Paragraph 17 of International Standard on Auditing (ISA) 260, Communication with Those Charged with Governance requires that in the case of listed entities, the auditor communicate with TCWG
example, questions have been raised about whether the Code should require firms and network firms to seek pre-approval of NAS from TCWG.

- Include more robust disclosure requirements about the nature of NASs provided to audit or assurance clients and the related fees charged.
- Establish fee caps in relation to NAS in order to mitigate the likelihood of audit firm fee dependency issues. It was pointed out that fee cap restrictions already exist in the ethics requirements of certain local jurisdictions (e.g., Europe and the US).
- Address fee related matters, including concerns about the accelerating growth of NAS that audit firms provide to NAS clients (i.e., issues relating to the firm business model).

24. The above calls for changes to the NAS provisions in the Code arise most often in relation to the provisions that apply to PIEs.

25. The calls for more robust requirements in relation to auditor communications with TCWG is based on a view that having increased transparency around the identification and evaluation of threats and the actions that auditors take to address those threats highlights the importance of viewing auditor independence as a joint responsibility (i.e., for the auditor and TCWG).

WG Views and Observations

Rationale for Having Global Principles-based Provisions

26. It is generally recognized that by providing NAS to their audit or assurance clients, firms and network firms may might create threats to compliance with the fundamental principles and to their independence.

27. One option for dealing with the existence of this inherent threat, would be to establish in the Code an all-inclusive and up-to-date list of NAS that firms and network firms might provide to their audit or assurance clients, together with appropriate provisions and prohibitions. However this is impractical because new NAS are created as a result of evolving business practices and financial markets, as well as advancing technologies.

28. For this reason, the approach taken in the Code includes:

- An overarching prohibition on assuming management responsibilities when providing a NAS to an audit or assurance client.
- Individual prohibitions on a firm or network firm providing particular services to an audit client

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16 Regulators: IRBA

17 See May 2017 Speech by PCAOB Board Member, Steve B. Harris titled, *Earning Investor Confidence.*
where the IESBA has determined that the threats created by providing those services cannot be eliminated or safeguards cannot be applied to reduce those threats to an acceptable level. Appendix 1 is a list of the NAS prohibitions in the Code that apply to PIEs.

- Specific provisions to assist firms and network firms apply the conceptual framework to identify, evaluate and address threats to independence when providing NAS to audit or assurance clients.

PIEs Versus Non-PIEs

29. The WG notes that the questions that have been raised about the Code having different NAS provisions that apply to audit or assurance clients that are PIEs versus those that are not PIEs. To-date, the WG notes that suggestions have been made about whether the Code should instead have provisions for audits of small and medium-sized entities (SMEs), owner-managed enterprises instead of PIEs versus non-PIEs, or some other classification.

30. Currently, the WG proposes to focus its attention on issues relating to the permissibility of NAS provided to audit or assurance clients that are PIEs as it considers that to be where the primary public interest lies.

Applying the Conceptual Framework – NAS

31. Following the completion of the Safeguards project, the Code includes material to assist firms and network firms to achieve a consistent application of the conceptual framework.

32. Paragraph 600.5 A1 includes a list of factors that firms and network firms may consider when evaluating the level of threats. Those factors include:

- The nature, scope and purpose of the service.
- The degree of reliance that will be placed on the outcome of the service as part of the audit.
- The legal and regulatory environment in which the service is provided.
- Whether the outcome of the service will affect matters reflected in the financial statements on which the firm will express an opinion, and, if so:
  - The extent to which the outcome of the service will have a material effect\(^{18}\) on the financial statements.
  - The degree of subjectivity involved in determining the appropriate amounts or treatment for those matters reflected in the financial statements.
- The level of expertise of the client’s management and employees with respect to the type of service provided.
- The extent of the client’s involvement in determining significant matters of judgment.
- The nature and extent of the impact of the service, if any, on the systems that generate information that forms a significant part of the client’s:

\(^{18}\) Drawing from the IAASB’s auditing standards, the Code includes new application material to explain materiality in relation to an audit client’s financial statements (see paragraph 600.5 A3).
r Accounting records or financial statements on which the firm will express an opinion.
  
- Internal controls over financial reporting.

- Whether the client is a public interest entity. For example, providing a non-assurance service to an audit client that is a public interest entity might be perceived to result in a higher level of a threat.

33. The Code also includes examples of actions, including safeguards, that might address threats to independence created by providing certain types of NAS. However, the Code emphasizes that such actions will only be safeguards if, individually or in combination, those actions effectively reduce the threats to independence that have been identified to an acceptable level [emphasis added]. The Code also makes it clear that there can be some situations where, when a threat is created by providing a NAS to an audit client, safeguards might not be available. In such situations, the firm is required to decline or end the NAS or the audit engagement (see paragraphs 600.6 A1 - 600.6 A2).

Materiality

34. The Code contains new application material relating to materiality in relation to an audit client’s financial statements. That application material explains that the determination of materiality involves the exercise of professional judgment, is impacted by both quantitative and qualitative factors, and is affected by perceptions of the financial information needs of users (see paragraph 600.5 A3).

35. The WG notes that there have been calls for the IESBA to include more guidance to explain the concept of materiality and significance in a broader context, for example in relation to financial interests. The WG believes that the considerations in such circumstances are different to those that arise in the context of NAS and so recommends that any consideration of how the concepts of materiality and significance apply in the broader context of the Code should be progressed as a separate work stream.

Advocacy Threats

36. The Code includes several revisions and refinements to address concerns about advocacy threats. Those revisions are reflected in the subsections that deal with valuation, tax, litigation support, legal and corporate finance services. The Code also emphasizes that assuming a management responsibility creates advocacy threats, in addition to familiarity threats, because the firm or network firm becomes too closely aligned with the views and interests of management.

37. As part of its benchmarking exercise, the WG will consider the nature of the threats that are created by each type of NAS and form a view about whether firms and network firms should continue to provide those NAS to audit or assurance clients that create advocacy threats.

Reconciliation of NAS Provisions in G-20 Jurisdictions

38. As noted above, the WG plans to undertake a benchmarking exercise that will involve comparing the NAS provisions in the Code to those in the local ethics requirements of the G-20 jurisdictions. The WG plans to focus its efforts on the provisions that apply to PIEs.

39. Through this exercise, the WG will seek to identify, understand and explain the similarities and differences between the NAS provisions in the Code and the local ethics requirements in the G-20 jurisdictions. The WG believes that this exercise will help inform its view about whether revisions or
refinements might be required to the NAS provisions in the IESBA Code in order for it to remain fit for purpose. For example, the WG is planning to form a view about whether the IESBA should:

- Continue to have the concept of materiality as a factor in determining the permissibility of certain types of NAS.
- Include additional NAS prohibitions in the Code.
- Establish new NAS provisions for additional types of NAS.
- Establish more robust provisions in relation to auditor communication with TCWG.

40. The WG expects that there will be some differences in the NAS provisions across the G-20 jurisdictions because local ethics requirements may prescribe additional specificity. Accordingly, the WG will seek assistance from regulators, national standard setters and others, as appropriate and practicable, in order to better understand the rationale those differences.

41. The WG will also seek to understand whether certain NAS provisions that exist in the ethics requirements of the G-20 jurisdictions might be better harmonized if there were to be a single set of globally understood descriptions of NAS, and the related types of threats that they might create when they are provided to an audit client.

42. The WG plans to present the final results of the reconciliation of NAS provisions to the IESBA as part of its report in December 2018. Before that, periodic updates will be provided as appropriate.

**Planned Approach to Roundtables**

43. The WG believes that stakeholder engagement will play an important part to the process of reconciling the differing perspectives about the principles that should be applied when developing provisions relating to NAS. For example, it will be important to decide on whether:

- The global independence provisions relating to NAS should continue to be principles-based or whether “bright-line” rules are more appropriate.
- There is agreement that, because it is not possible to identify all NAS and all situations that might create threats, the conceptual framework should provide the overarching framework applicable that should apply in all situations.
- The enhanced conceptual framework provides a strong enough foundation for NAS provisions.

44. The WG believes that roundtables are a useful forum to bring together stakeholders with differing views to share their perspectives on specific aspects of a particular issue. Roundtables allow a two-way dialogue which facilitates a better understanding of viewpoints and an exploration of practical and pragmatic solutions.

45. The WG notes that there have been concerns about the level of transparency and objectivity in the process of summarizing roundtable discussions, leading to undue reliance on the views expressed by certain individuals or groups when determining a basis for changing standards. The WG believes that these concerns might be mitigated by:

- Selecting a diverse group of roundtable participants who are informed and knowledgeable about the topic and current issues.
- Leveraging technology to make the roundtable accessible to online observers.
46. As noted above, global roundtables are being planned for June-July 2018. Save the Dates notices will soon be circulated to promote and solicit stakeholders' interest in the events. In order to best manage space limitations, roundtable participation will be by invitation only. In relation to NAS, a briefing paper will be circulated to roundtable participants in advance of the event.

**Planned Timeline**

47. The WG's proposed timetable for the NAS initiative is as follows:

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<thead>
<tr>
<th>Date</th>
<th>Planned Activities</th>
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<tr>
<td>March 2018</td>
<td>Initial IESBA and CAG Discussions</td>
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<tr>
<td>April 2018</td>
<td>WG meeting</td>
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<tr>
<td>June-July 2018</td>
<td>Roundtables</td>
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<tr>
<td>August 2018</td>
<td>WG meeting</td>
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<tr>
<td>September 2018</td>
<td>IESBA and CAG Discussions – Consideration of feedback from Roundtables</td>
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<tr>
<td>December 2018</td>
<td>Report of fact-finding and WG recommendations</td>
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**Matter for CAG Consideration**

1. Representatives are asked for views about:

   (a) The issues and the WG’s views and observations summarized in this paper.

   (b) The WG’s planned approach to fact-finding, including its plan for roundtables.

   (c) The WG’s planned timeline.
Overview of NAS Prohibitions in IESBA Code for Audits of Entities that are PIEs

The NAS prohibitions in the Code that apply to audits of entities that PIEs relate to:

1. Accounting and bookkeeping services, including preparing financial statements. The Code includes an exception to this prohibition for accounting and bookkeeping services that is of routine and mechanical nature for divisions and related entities if the divisions and the service are *immaterial* (see paragraphs R601.6 and R601.7).

2. Valuations services, including tax services involving valuation that have a *material* effect on the financial statements on which the firm will express an opinion (see paragraph R603.5).

3. Preparing tax calculations of current and deferred tax liabilities (or assets) for the purpose of preparing accounting entries that are *material* (see paragraph R604.6).

4. Tax planning and other tax advisory services when the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements, and audit team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation and the outcome of the tax advice is *material* (see paragraph R604.8).

5. Tax services that involve assisting in the resolution of tax disputes if the services involve acting as an advocate for the audit client before a public tribunal or court, and the amounts involved are *material* (see paragraph R604.11).

6. Internal audit services relating to (see paragraph R605.5):
   - A significant part of the internal control over financial reporting (ICFR);
   - Financial accounting systems that generate information that is, individually or in the aggregate, *material* to the client’s records; or
   - Amounts or disclosures that are, individually or in the aggregate, *material* to the financial statements.

7. Information technology (IT) system services involving designing or implementing IT that form a significant part of the ICFR or generate information that is, individually or in the aggregate, significant to the client’s records (see paragraph R606.5).

8. Legal services that involve acting as General Counsel for legal affairs, and acting in an advocacy roles for an audit client in resolving a dispute or litigation when the amounts involved are material (see paragraphs R608.5 and R608.6).

9. Recruiting services that involve acting as a negotiator on the client’s behalf (see paragraph R609.6).

10. Recruiting services relating to searching for or seeking out candidates; or undertaking reference checks of prospective candidates, with respect to (see paragraph R609.7):
    (a) A director or officer of the entity; or
    (b) A member of senior management in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion.

Agenda Item F
Page 12 of 13
11. Corporate finance services that involve promoting, dealing in, or underwriting the audit client’s shares (see paragraph R610.4)

12. Corporate financial advice where the effectiveness of such advice depends on a particular accounting treatment or presentation in the financial statements and the audit team has reasonable doubt as to appropriateness; and the outcome or consequences of the advice will have a *material* effect on the financial statements (see paragraph R610.5).