

## Benchmarking Initiative – Working Draft of Phase 1 Report As of September 3, 2021

This document is a working draft report of the Benchmarking Working Group's (WG) Phase 1 work as of September 3, 2021. It is provided to members for reference and intended to illustrate the structure and the granularity of information proposed for inclusion in the final Phase 1 report.

The document includes the WG's conclusions on the focus areas and topics that were reviewed through August 2021. It includes placeholders and is subject to revisions and refinements to:

- Incorporate focus areas and topics to be analyzed in Q4 2021.
- Reflect the WG's final interpretations and conclusions based on their analysis.
- Incorporate the input from IESBA members and IESBA Consultative Advisory Group, as well as targeted stakeholder outreach to be undertaken in Q4 2021.

### I. Introduction

#### Objective of the Benchmarking Initiative

1. The IESBA's benchmarking initiative compares the provisions of the IESBA's [International Code of Ethics for Professional Accountants \(including International Independence Standards\)](#), (the Code) with corresponding provisions in the laws and regulations of other jurisdictions that address auditor independence, including:
  - (a) The nature of the relationship between an auditor and an audit client, and
  - (b) The activities and services that may and may not be provided by an auditor to an audit client.
2. The comparison is intended to highlight the similarities and differences between the Code and the different jurisdictional-level independence rules and regulations. This initiative does not extend to making judgments as to the relative merits of the different approaches, rules or regulations.
3. The objective of this initiative is to promote awareness and adoption of the current version of the Code, especially the International Independence Standards (IIS).<sup>1</sup> It will also help the IESBA to identify any specific provisions of the IIS and the Code that it should review and, if appropriate, address as part of its future strategy and work plan.

#### *About this Report*

4. The report summarizes the outcome of Phase I of the IESBA Benchmarking Initiative. The initiative involved comparing the current IIS that are applicable to public interest entities (PIEs)

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<sup>1</sup> The current version of the Code includes all revisions that were approved by the IESBA as of December 2020, namely:

- [Revised Part 4B](#), *Independence for Assurance Engagements Other than Audit and Review Engagements* which became effective in June 2021.
- The [revisions](#) arising from the Role and Mindset Expected of Professional Accountants project that will become effective in December 2021.
- The revisions relating to the objectivity of an engagement quality reviewer and an appropriate reviewer that will become effective in December 2022.
- The Non-Assurance Service (NAS) and fee-related revisions to the Code that will become effective in December 2022.

with the independence requirements for entities subject to the US Securities and Exchange Commission (SEC/ the Commission) and the US Public Company Accounting Oversight Board (PCAOB) (collectively “SEC/PCAOB”). The comparison in this report (the ‘Report’) focuses primarily on the independence requirements of the SEC and refers to the PCAOB independence requirements only where those requirements are more stringent than the SEC’s framework.

5. The provisions of the Code and the SEC/PCAOB rules are not directly comparable because, as explained in Section II, they have different jurisdictional bases and so adopt different conceptual approaches. The analysis in this Report therefore focuses on whether the provisions/rules address the same issues and achieve the same substantive outcomes.
6. This Report does not amend or override the Code, the text of which alone is authoritative, and does not constitute an authoritative or official pronouncement of the IESBA. Reading this Report is not a substitute for reading the Code. Readers are also cautioned to apply judgment in reading and interpreting this Report within the context of their jurisdiction.

#### *Focus Areas and Topics*

7. This Report reflects the IESBA Staff’s understanding of the respective frameworks being compared. The IESBA Staff developed this Report based on input received from the IESBA’s Benchmarking Working Group and the IESBA.
8. This Report deals with focus areas and topics that are greatest interest to IESBA, users of the Code and other stakeholders. These focus areas and topics include:
  - Overarching Principles and Approach (including non-compliance with laws and regulations)
  - Key Definitions
  - Fee-related Provisions
  - Permissibility of NAS to Audit Clients, Including Prohibited Services
  - Auditors’ Communication with Those Charged With Governance (TCWG) about Independence Matters [Including Pre-approval of Non-Assurance Services (NAS) and Disclosures about Fees]
  - Financial Relationships
  - Business Relationships
  - Partner Rotation/Long Association
  - Gifts and Hospitality
9. The identification of the areas to be considered in this Report does not imply that those areas would be more important to auditor independence than other topics or standards not considered in this Report.

## **II. Overarching Principles**

### **The Fundamental Principles and the Conceptual Framework**

10. The Code establishes five fundamental principles with which all professional accountants and firms are required to comply in all circumstances. The Code also requires accountants to apply a specified conceptual framework to identify, evaluate and address threats to compliance with those

fundamental principles. Applying the conceptual framework requires exercising professional judgement, having an inquiring mind, and using the reasonable and informed third party test.

11. Under the Code's conceptual framework, a professional accountant is required to identify whether any threat to compliance with the fundamental principles exists and, if so, to evaluate that threat to determine whether it is at an acceptable level.<sup>2</sup> If the threat is not at an acceptable level, the conceptual framework requires the accountant to address that threat by either:

- a) Eliminating the circumstances, interests or relationships that are creating the threat;
- b) Applying safeguards, where available and capable of being applied, to reduce the threat to an acceptable level; or
- c) Declining or ending the specific professional activity [or engagement that gives rise to the threat].

The Code's (including the IIS) requirements and application material are collectively referred to as the Code's provisions. The Code's provisions are interconnected by design—using a “building blocks” approach and drafting conventions that minimize duplication. Therefore, the provisions in Part 1 apply equally across all professional activities and are not repeated in Parts 2, 3 and 4, except for emphasis. This approach demonstrates the scalability of the Code's provisions and emphasizes the overarching principles-based provisions that apply to all accountants in all situations.

#### *Independence*

12. In addition, the Code includes the IIS which require professional accountants to be independent when performing audit, review, and other assurance engagements. A professional accountant undertaking an assurance engagement is also required to apply the conceptual framework to identify, evaluate, and address threats to independence. Applying safeguards is one way that threats to independence might be addressed. The Code provides examples of safeguards that might be applied to reduce a threat to independence an acceptable level.
13. The Code's requirements are designated with the letter “R” and in most cases include the word “shall”. Some requirements explicitly prohibit certain relationships between the auditor and the audit client, or the provision of particular activities or services to the audit client. The Code also includes application material which provides context that is relevant to a proper understanding of the requirement or provision to which it relates. While such application material does not itself impose a requirement, consideration of the material is necessary for the proper application of the requirements of the Code, including the application of the conceptual framework. Application material is designated with the letter “A”.
14. The Code includes requirements and application material that are applicable when a professional accountant is providing professional services to a “public interest entity”, a category that includes entities listed on a regulated exchange (see paragraph 41 below).

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<sup>2</sup> Based on paragraph 120.7 A1 of the Code an acceptable level is a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles.

## The SEC/PCAOB Rules

### SEC Rules

15. The independence rules of the SEC must be complied with for audits required by US federal securities laws, including audits of the financial statements of issuers<sup>3</sup>. Regulation S-X<sup>4</sup> sets out the form and content of and requirements for financial statements required to be filed with the Commission, including the requirements for auditor independence.
16. [Rule 2-01 of Regulation S-X](#) requires auditors to be qualified and independent of their audit clients both in fact and in appearance. Accordingly, Rule 2-01 sets out restrictions, among others, on financial, employment, and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non-audit services to an audit client.<sup>5</sup>
17. Rule 2-01(b)<sup>6</sup> provides, as a general standard of auditor independence, that  
*“The [Security and Exchange] Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.”*
18. Rule 2-01(c)<sup>7</sup> includes a non-exclusive list of specific rules and restrictions that are intended to reflect the general standard's application to particular circumstances. However, in cases where Rule 2-01 (c) does not address specific situations or circumstances, accountants are required to consider the general standard to determine whether their independence is compromised.
19. Rule 2-01<sup>8</sup> also states that “the rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in §210.2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service:
  - creates a mutual or conflicting interest between the accountant and the audit client;
  - places the accountant in the position of auditing his or her own work;
  - results in the accountant acting as management or an employee of the audit client; or

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<sup>3</sup> Based on Sarbanes Oxley Act of 2002, Section (2)(a)(7), the term “issuer” means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

<sup>4</sup> 17 C.F.R. Part 210

<sup>5</sup> In considering Regulation S-X, regard has been given to the following independence related amendments, including in:

- [SEC Release \(2000\) - Revision of the Commission's Auditor Independence Requirements](#)
- [SEC Release \(2003\) - Strengthening the Commission's Requirements Regarding Auditor Independence](#)
- [SEC Release \(2019\) - Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships](#)
- [SEC Release \(2020\) – Qualification of Accountants](#)

<sup>6</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (b)

<sup>7</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c)

<sup>8</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 Introductory note

- places the accountant in a position of being an advocate for the audit client.”

#### PCAOB Rules

20. Audits of issuers (and broker-dealers) must also be performed in accordance with the rules of the PCAOB. The PCAOB adopted ethics and independence standards (i) issued by the PCAOB and approved by the SEC ([PCAOB rules](#)), and (ii) - on an interim basis - promulgated by other bodies, including the AICPA ([Interim Ethics and Independence Standards](#)). The Interim Ethics and Independence Standards consist of the
  - Ethics standards in the AICPA's Code of Professional Conduct, and interpretations and rulings thereunder, in existence on April 16, 2003, to the extent not superseded or amended by the PCAOB, and
  - Independence Standards of the Independence Standards Board.
21. The PCAOB did not adopt the SEC independence rules, since those rules were already applicable to auditors of SEC issuers. Where SEC rules and a PCAOB rules and interim standards are not equivalent, auditors of issuers (and broker-dealers) are required to comply with the more restrictive provision.<sup>9</sup>
22. In preparing this Report, the IESBA Staff took an incremental approach and focused primarily on the SEC rules and those PCAOB rules that are more restrictive than the SEC Rules. The Report only includes reference to PCAOB Interim Ethics and Independence Standards if, based on IESBA Staff's evaluation, those are more restrictive than the SEC rules and are relevant to the comparison. This Report does not purport to make reference to all differences between the SEC and PCAOB requirements.

#### **The IESBA and SEC/PCAOB Frameworks compared<sup>10</sup>**

##### *Global Framework / Jurisdictional Framework*

23. The Code and the SEC/PCAOB rules address fundamentally different objectives, which result in the different approaches that each has adopted:
  - (a) The Code applies to all professional accountants irrespective of the professional activity undertaken and the IIS apply to accountants performing audits, reviews or other assurance engagements for any entity. The SEC and PCAOB rules apply to auditors of issuers, as well as certain other entities where compliance with SEC Rule 2-01 and PCAOB rules is required
  - (b) The Code is prepared for adoption in any jurisdiction in the world and its application relies on national laws and regulations in that jurisdiction. The SEC and PCAOB rules are developed for application in accordance with the relevant US legislation and regulation.
  - (c) The IESBA Code applies when professional activities/ services are provided to all entities, irrespective of their size, business and market specificities. As there is a higher expectation

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<sup>9</sup> In late 2020, the PCAOB made targeted conforming amendments to their independence rules to (i) avoid differences between the SEC and PCAOB independence rules; (ii) avoid duplicative requirements; and (iii) provide greater regulatory certainty.

<sup>10</sup> There are situations where only the SEC/ PCAOB rules set out specific prohibitions or other requirements. However, given the difference in the overarching approaches, the proper application of the Code's conceptual framework would result in the conclusion to eliminate the specific factor compromising the firm's independence or to withdraw from the engagement. Therefore, the IESBA Staff believes it is necessary that the benchmarking documents also present how the conceptual framework or the general standard would apply in specific circumstances. The IESBA Staff considered such analysis while forming conclusions about the similarities and differences of the provisions/rules.

regarding the independence of firms auditing PIEs, the Code includes specific provisions addressing relationships with and services provided to those entities. The SEC/PCAOB rules address the relationships and provisions of services to audit clients having greater public interest relevance.

*Application of the Conceptual Framework / General Independence Standard*

- 24. Neither the Code nor the SEC framework is entirely “rules-based” or entirely “principles-based”. Both frameworks include strong overarching principles that are supported with specific requirements (a “hybrid approach”).
- 25. Under both the Code and the SEC rules, determination of “independence” requires consideration of both independence in mind/in fact and independence in appearance:

<b>Code</b> (Independence in mind)	<b>SEC</b> (Independence in fact)	<b>Code</b> (Independence in appearance)	<b>SEC</b> (Independence in appearance)
<p>“Independence of mind - the state of mind that permits the <u>expression of a conclusion without being affected by influences that compromise professional judgment</u>, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.”</p>	<p>“The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, (...) capable of <u>exercising objective and impartial judgment on all issues</u> encompassed within the accountant's engagement.”</p>	<p>“Independence in appearance - the avoidance of facts and circumstances that are so significant that <u>a reasonable and informed third party would be likely to conclude that a firm's, or an audit team member's, integrity, objectivity or professional skepticism has been compromised.</u>”</p>	<p>“The Commission will not recognize an accountant as independent, with respect to an audit client, if (...) <u>a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues</u> encompassed within the accountant's engagement.”</p>

- 26. Under both frameworks, the “reasonable and informed third party” test / “reasonable investor with knowledge of all relevant facts and circumstances” test has a significant role in the assessment of a firm’s independence. In the Code, the “reasonable and informed third party test” is also a basis for evaluating whether a threat to independence is at an acceptable level. Similarly, when applying the general standard in the SEC rules in circumstances other than the ones addressed by Rule 2-01(c), the four principles in the introductory paragraphs should be applied when considering Rule 2-01(b) when determining whether the firm is independent.

27. Both frameworks set out similar fundamental objectives (or principles) by which an auditor's independence is assessed when applying the Code's conceptual framework or determining compliance with the SEC's general independence standard.<sup>11</sup>

<p><i>Concepts in IESBA's Conceptual Framework and Overarching Principles to Independence that are Analogous to SEC's General Standard</i></p>	<p><i>SEC's Rule 2-01 Introductory Note</i><sup>12</sup></p> <p>"The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in §210.2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service:"</p>
<p>A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.<sup>13</sup></p>	<ul style="list-style-type: none"> <li>creates a mutual or conflicting interest between the accountant and the audit client</li> </ul>
<p>Self-interest threat - the threat that a financial or other interest will inappropriately influence a professional accountant's judgment or behavior.</p>	
<p>Familiarity threat - the threat that due to a long or close relationship with a client, or employing organization, a professional accountant will be too sympathetic to their interests or too accepting of their work.</p>	
<p>Intimidation threat - the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.</p>	
<p>Self-review threat - the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the accountant, or by another individual within the accountant's firm or employing organization, on which the accountant will rely when</p>	<ul style="list-style-type: none"> <li>places the accountant in the position of auditing his or her own work.</li> </ul>

<sup>11</sup> The table below only includes the high-level concepts of the fundamental objectives (or principles) from each framework. The specific provisions supporting these objectives (or principles) are presented in the sections below.

<sup>12</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (b)

<sup>13</sup> Part III – Professional Accountant in Business, Section 310, Conflict of Interest, Paragraph R310.4. Based on the Code's building blocks approach, requirements and application material in Part III of the Code are also applicable in the context of the IIS.



forming a judgment as part of performing a current activity.	
A firm or a network firm shall not assume a management responsibility for an audit client. <sup>14</sup>	<ul style="list-style-type: none"> <li>• results in the accountant acting as management or an employee of the audit client</li> </ul>
Advocacy threat - the threat that a professional accountant will promote a client's or employing organization's position to the point that the accountant's objectivity is compromised;	<ul style="list-style-type: none"> <li>• places the accountant in a position of being an advocate for the audit client.</li> </ul>

#### *Evaluation of Threats*

28. Although both frameworks set out similar fundamental objectives (or principles), the assessment and the application of those principles are different in the two independence frameworks.
29. The SEC's framework requires an auditor to determine whether the provision of a particular service or relationship would create a threat to compliance with the overarching principles and, if so, prohibits the provision of that service or relationship regardless of the materiality or significance of the threat.
30. Under the Code, provided the relationship or provision of a specific service is not explicitly prohibited, the application of the conceptual framework requires the auditor to identify threats to compliance with the fundamental principles, to evaluate the level of a threat identified and then to determine whether any safeguards are available and capable of reducing that threat to an acceptable level. If not, the Code requires the auditor to end the specific professional activity

#### *Commentary*

31. The two frameworks prescribe different processes for the determination of whether a relationship or service is prohibited.
  - a) The Code focuses on the possibility that a service or relationship may give rise to a threat – and then on whether that potential threat is at or can be reduced to an acceptable level. Only if the threat cannot be reduced to an acceptable level is the service or relationship prohibited.
  - b) By contrast, the SEC prohibits services or relationships that would involve a breach of the overarching principles. As a result, a firm's assessment focuses on whether any of the overarching principles will be breached; rather than on the possibility that there might be a breach of those principles. And, as safeguards are not permitted under the SEC rules, the consequences are clear-cut.

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<sup>14</sup> Paragraph R410.13 of the Code



32. On one view, the Code is stricter because it focuses on potential threats and then requires firms to put in place safeguards. On another view, the SEC rules are stricter because they do not permit safeguards to address situations where a service or relationship would otherwise breach the overarching principles. An all encompassing comparative evaluation is, therefore, not possible as much will turn on the specific circumstances.

*Mutual or Conflicting Interest with the Audit Client*

[To be completed]

*Assuming Management Responsibility*

33. The Code prohibits firms assuming a management responsibility for an audit client.<sup>15</sup> That prohibition applies to all aspects of the relationship between a firm and an audit client. The Code provides that management responsibility involves “controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.”<sup>16</sup>
34. To support compliance with this overarching principle, the Code includes a requirement that firms be satisfied that the management of the audit client makes all judgments and decisions that are their proper responsibility.<sup>17</sup>
35. The SEC rules include a general prohibition on acting as management [and also prohibit a firm from acting as an employee of an audit client.]
36. Aside from this overarching prohibition, the SEC rules include a specific ban for the provision of any non-audit service that would constitute a management function, i.e., “acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.”
37. The table below includes the relevant provisions of the Code and SEC rules:

Code’s revised provisions	SEC rules
R400.13 A firm or a network firm shall not assume a management responsibility for an audit client.	2-01 (b) <sup>18</sup> In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service (....) results in the accountant acting as management or an employee of the audit client; (....)
400.13 A1 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources. (...)	2-01 (c) (4) <sup>19</sup> An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client
R400.14 When performing a professional activity for an audit client, the firm shall be	(vi) Management functions. Acting, temporarily or permanently, as a director, officer, or

<sup>15</sup> Revised paragraph R400.13 of the Code

<sup>16</sup> Revised paragraph 400.13 A1 of the Code

<sup>17</sup> Revised paragraph R400.14 of the Code

<sup>18</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (b)

<sup>19</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (vi)

<p>satisfied that client management makes all judgments and decisions that are the proper responsibility of management. This includes ensuring that the client's management:</p> <p>(a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the activities. Such an individual, preferably within senior management, would understand:</p> <p>(i) The objectives, nature and results of the activities; and</p> <p>(ii) The respective client and firm or network firm responsibilities.</p> <p>However, the individual is not required to possess the expertise to perform or re-perform the activities.</p> <p>(b) Provides oversight of the activities and evaluates the adequacy of the results of the activities performed for the client's purpose.</p> <p>(c) Accepts responsibility for the actions, if any, to be taken arising from the results of the activities.</p>	<p>employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.</p>
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#### Commentary

38. Both frameworks prohibit a firm assuming management responsibility for an audit client. However, the SEC's prohibition applies regardless of the significance of the activity and would, therefore, include matters that are routine and administrative. Consequently, there are some activities that are not prohibited by the Code, but are prohibited under the SEC rules. These differences arise from the following:
- a) The SEC's overarching principle extends to any relationships or services that would result in a firm acting as employee for an audit client. The Code does not include such a prohibition and in some instances, e.g., in the case of administrative services, it allows the provision of services that the SEC would prohibit as "employee activities" (see paragraph 102 ).
  - b) The SEC rules provide that performance of a management function includes activities such as acting, temporarily or permanently, as a director, officer, or employee of an audit client which are therefore prohibited. In contrast, the Code allows for personnel to be loaned to an audit client for a short period of time, if certain conditions are met.<sup>20</sup>

#### Non-Compliance with Laws and Regulations

[To be completed]

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<sup>20</sup> Paragraph R525.4 of the Code

### III. Key Definitions

39. A comparison of the key definitions is central to any benchmarking of the Code to the SEC or PCAOB rules, as substantive differences in those key definitions can materially affect the ambit and efficacy of the substantive provisions.

#### **Audit Client and Related Entities/ Affiliates**

##### *Audit Client*

40. In the Code, the term 'audit client' is defined as any entity in respect of which a firm conducts an audit engagement, and the IIS apply to all firms and professional accountants undertaking such audit engagements.
41. The Code contains supplementary provisions that are applicable to audits of PIEs. PIEs are defined in the Code as:
- a) A listed entity; or
  - b) An entity:
    - i. Defined by regulation or legislation as a PIE; or
    - ii. For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation might be promulgated by any relevant regulator, including an audit regulator.<sup>21</sup>
42. In the context of SEC rules, the audit client means the entity whose financial statements or other information is being audited, reviewed, or attested to and any affiliates of the audit client.<sup>22</sup>
43. The SEC/PCAOB rules apply, among others, to audit firms and professional accountants that audit financial statements of 'issuers'. For purposes of this Benchmarking initiative, the term 'issuer' used in the SEC rules and 'listed entity' used in the PIE definition in the Code are equivalent. Although the Code applies to a wider group of entities than the SEC rules – by virtue of sub-paragraph (b) of the PIE definition - this Report compares the provisions of the Code to be complied with by auditors of PIEs with the requirements of the SEC rules.

##### *Related Entities/ Affiliates*

44. In the Code, the definition of an audit client includes its 'related entities'. Under the Code the related entities that are included in the definition of a PIE audit client that is a listed entity differ from the related entities if the audit client is an unlisted PIE.<sup>23</sup>
45. Under the SEC rules, the definition of an audit client includes all 'affiliates'. It is therefore necessary to compare the definitions of 'related entities' in the Code with the definition of 'affiliates' under the SEC rules to determine whether the application of the Code and the SEC rules to other entities within a group is equivalent in scope.

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<sup>21</sup> Please refer to the Glossary of the Code

<sup>22</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01(f) (6)

<sup>23</sup> Paragraph R400.20 of the Code provides that 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

46. The table below summarizes the related entities of PIE listed audit clients under the Code and affiliates under the SEC rules:

Code - Related entities	SEC/PCAOB - Affiliates <sup>24</sup>
(a) An entity that has direct or indirect control over the client if the client is material to such entity;	(i) An entity that has control over the entity under audit, or over which the entity under audit has control, including the entity under audit's parents and subsidiaries;
(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;	(iv) An entity that has significant influence over the audit client, unless the audit client is not material to the entity; or
(c) An entity over which the client has direct or indirect control;	See point (i)
(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	(iii) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;
(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.	(ii) An entity that is under common control with the entity under audit, including the entity under audit's parents and subsidiaries, when the entity and the entity under audit are each material to the controlling entity;
	(v) Each entity in the investment company complex as determined in paragraph (f)(14) of this section when the entity under audit is an investment company or investment adviser or sponsor, as those terms are defined in paragraphs (f)(14)(ii), (iii), and (iv) of this section.

Commentary

47. There are two differences in the definitions in the two frameworks:

- The Code excludes entities that control an audit client if the audit client is immaterial to the controlling entity, whereas SEC rules include them; and
- The Code includes relationships that result in significant influence only if that influence arises from a direct financial interest;<sup>25</sup> the SEC rules apply irrespective of how that significant

<sup>24</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01(f) (4)

<sup>25</sup> See point (b) and (d) of the definition of related entities in the Glossary of the Code

influence arises.<sup>26</sup>

In both instances, the differences result in the SEC rules having a wider application.

48. The SEC rules also define investment company complexes<sup>27</sup> and address which companies constitute affiliates of audit client that are included in investment company complexes. Given its global context, the Code does not include specific provisions for investment company complexes. However, when adopting the recent changes to NAS and fee-related provisions of the Code, the IESBA considered the application of those revisions to investment company complexes, such as private equity complexes, and the Code revisions address the challenges arising from the complex structure of such entities<sup>28</sup>.

#### **Network Firms/ Associated Entities**

49. Under the Code, firms and network firms are both required to be independent of their audit clients and the Code specifically states whether a specific provision applies not only to an audit firm, but also to any network firm.<sup>29</sup> In this Report, when referring to the use of ‘firm’ in the context of the Code, ‘firm’ includes network firms.
50. The SEC rules do not address specifically the position of network firms. However, the definition of an “accounting firm” includes the accounting firm’s “associated entities” and therefore the independence rules applicable to an accounting firm also apply to its “associated entities”. In interpreting the rule, the SEC has regard to all the relevant facts and circumstances.<sup>30</sup>

#### **Commentary**

51. As the SEC Staff’s practice is to have regard to all the relevant facts and circumstances when applying its definition of an “accounting firm”, it is not possible to provide a comprehensive list of all the types of entities that the SEC would regard as being within the definition of an accounting firm. However, both frameworks appear to have the same objective – namely to address the position of those firms which are required to be independent of an audit client.

#### **Audit team**

52. The Code defines an “audit team” as
- All members of the engagement team for the audit engagement,
  - All others within a firm who can directly influence the outcome of the audit engagement,
  - All those within a network firm who can directly influence the outcome of the audit engagement.<sup>31</sup>
53. The SEC rules define the “audit engagement team” as
- “All partners, principals, shareholders and professional employees participating in an audit, review, or attestation engagement of an audit client, including audit partners and all persons*

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<sup>26</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (4) point (iii) and (iv)

<sup>27</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01(f)(14)

<sup>28</sup> Please refer to [Basis for Conclusions, Revisions to Fee-related Provisions of the Code](#), paragraphs 131 to 136

<sup>29</sup> Paragraphs 400.50 A1 to 400.54 A1 of the Code

<sup>30</sup> Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence – Frequently Asked Questions, [K. Definitions](#), Question 1

<sup>31</sup> Please refer to the Glossary to the Code

*who consult with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events”.*<sup>32</sup>

54. When comparing the provisions of the Code and the SEC rules, it is relevant to note that the Code generally focuses on the audit team as the base, while the corresponding SEC rules apply to “covered persons” as well as to the members of the audit team (as defined). “Covered persons”<sup>33</sup> includes, but is not limited to, the partners, principals, shareholders, and employees of an accounting firm who form part of
- The “audit engagement team”;
  - The “chain of command”; and
  - Other partners, principals, shareholders, and managerial employees described in the next paragraph.

#### Commentary

55. The Code’s provisions apply to different individuals depending on the topic/area of the relationship. Where the Code’s provisions are relevant to the audit team only, the SEC rules are broader as the SEC rules apply to individuals who are not addressed in the Code’s audit team definition, namely:
- Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of non-audit services to the audit client in the relevant time period, and
  - Any other partner, principal, or shareholder from an “office” of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.
56. However, in the case of the prohibition on holding financial interests in the audit client<sup>34</sup>, the Code adopts a similar approach as SEC rules, and also includes other partners and managerial employees in the firm providing a NAS to an audit client as persons to whom that prohibition applies.

#### Key Audit Partner/ Audit Partner

57. The Code<sup>35</sup> and the SEC rules<sup>36</sup> adopt the same approach when defining a “key audit partner” (in the Code) and an “audit partner” (in the SEC rules). Whilst the individuals identified in the definition in each framework differ, both frameworks include the same categories of individuals, namely (a) the engagement partner/lead partner (b) the engagement quality reviewer (EQR), and (c) other audit partners who make key decisions or judgments on significant matters with respect to the audit.

#### Commentary

58. The differences arise from the fact that SEC definition includes:
- Any partner on the engagement team who maintains regular contact with management and the audit committee (whereas the Code only includes a partner who makes key decisions or judgments on significant matters); and

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<sup>32</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (7) (i)

<sup>33</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (11)

<sup>34</sup> Paragraph R510.4 (c)-(d) of the Code

<sup>35</sup> Please refer to the Glossary to the Code

<sup>36</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (7) (ii)

- Other audit engagement team partners who provide more than ten hours of audit, review, or attest services in connection with the annual or interim consolidated financial statements of the issuer or an investment company.

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*[Placeholder for other sections of the Report]*

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#### **IV. Provision of Non-Assurance/ Non-audit Services to Audit Clients**

59. The Code and the SEC rules have the same overarching objective, namely, to ensure that the provision of additional services to audit clients does not compromise an audit firm's independence. In both frameworks, the approach taken is very similar. Both frameworks rely on strong overarching principles, complemented by a list of specific prohibited services.
60. Although the conceptual approach adopted by the two frameworks is similar, the relevant section of the Code<sup>37</sup> applies only to the provision of non-assurance services to audit and review clients<sup>38</sup>, and the provision of assurance services other than audit and review, and audit-related services, are governed by the fundamental principles and the conceptual framework. The SEC rules<sup>39</sup> identify specific services that firms are prohibited from providing to audit clients (irrespective of whether they are non-assurance or non-audit services), and the general standards and overarching principles apply to all other services provided to an audit client.
61. This section compares the overarching principles relevant to the provision of non-audit/non-assurance services to an audit client and then, separately, compares the specific services prohibited under each framework. The role of TCWG in relation to the provision of NAS or non-audit services is considered in Section [\*\*].

##### *Overarching Principles Relevant to the Provisions of NAS/ Non-audit Services to an Audit Client*

62. Under the Code, when a firm is determining whether to provide a NAS to a PIE audit client the firm first considers
- The laws and regulations in the specific jurisdiction relating to the provision of NAS<sup>40</sup>,
  - Whether the provision will result in the firm assuming management responsibility<sup>41</sup>
  - Whether 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<sup>42</sup>
  - Whether any other threats identified (self-interest, familiarity, advocacy and/or intimidation) are at an acceptable level<sup>43</sup>

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<sup>37</sup> Revised Section 600 of the Code

<sup>38</sup> The provisions in the IIS apply to both audit and review engagements. The terms "audit," "audit team," "audit engagement," "audit client," and "audit report" apply equally to review, review team, review engagement, review client, and review engagement report. (See paragraph 400.2 in the Code)

<sup>39</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4)

<sup>40</sup> Revised paragraph 600.6 A1 of the Code

<sup>41</sup> Revised paragraph 600.7 A1 of the Code

<sup>42</sup> Revised paragraph R600.8 of the Code

<sup>43</sup> Revised paragraph R600.14 of the Code



63. The SEC’s approach with respect to services provided by auditors is largely founded on the core principles presented in paragraph 17-19, violations of which would impair the auditor’s independence.

Commentary

64. The Code and the SEC rules are based on the application of the fundamental principles/overarching principles to the provision of NAS/ non-audit services to audit clients. Those principles are required to be complied with when firms provide services that are not mentioned specifically in the respective standards to audit clients.
65. As the Code is applicable at a global level and its application is subject to the national laws and regulations in each jurisdiction, the Code also requires consideration of whether national laws and regulations differ from or go beyond the Code’s provisions.

*Management responsibility*

66. The approaches taken to the assumption of management responsibility in the Code and the SEC rules are considered in paragraph 38 above.

*Prohibition on Self-review*

67. Under both frameworks, the risk of the auditor being placed in a position of auditing his/her own work is a key consideration when determining whether an auditor can provide a specific service to an audit client.<sup>44</sup>
68. The 2021 revisions to the Code introduced a new, overarching requirement in the IIS that prohibits audit firms from providing a 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.
69. The use of “*might create*” in the Code’s provision means that the provision of a NAS is prohibited once a firm identifies a risk that a self-review threat might be created – as opposed to where that firm concludes that a self-review threat will in fact be created - and is intended to reduce the risk that a firm might incorrectly conclude (a) that a proposed NAS will not create a self-review threat, or (b) that the outcome of the proposed NAS will not be subject to audit procedures, thereby circumventing the prohibition.
70. The Code does not include any specific prohibitions that apply where a firm provides assurance services to an audit client. The Code requires the firm to apply the conceptual framework and determine whether the self-review threat, and any other threats, created by the provision of the proposed assurance service to the audit client are at an acceptable level, and if not, to address such threats.
71. In line with the overarching principles, the SEC rules contain an absolute prohibition against accountants providing services to an audit client if that service places them in the position of auditing their own work.
72. The SEC rules also include a “*not subject to audit*” exception that applies in respect of a specific set of services, as described in paragraphs 83 to 88.

Commentary

73. In practice, the approach of the two frameworks is the same. Under the IESBA Code any situation where a self-review threat might exist is prohibited for PIE audit clients. For entities subject to the

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<sup>44</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 Introductory note

SEC rule there is a fundamental principle that an auditor cannot be in a position (or be perceived to be in a position) of auditing his/her own work.

*The risk of self-review arising from the provision of advice and recommendations*

74. The Code acknowledges that provision of advice and recommendations, whether as a separate engagement or in the course of providing a specific NAS, might create a self-review threat and, as a general rule, prohibits the provision of advice and recommendations to a PIE audit client that might create a self-review threat.
75. As an exception to the application of the self-review threat prohibition, the Code allows the provision of advice and recommendations that might create a self-review threat if such NAS arise out of the normal course of an audit, provided that the other conditions in paragraph 6263 above are complied with (i.e., it is not prohibited under local laws and regulations, does not involve the assumption of a management responsibility, and does not result in other threats to independence being at higher than an acceptable level).<sup>45</sup>
76. The SEC rules do not include any rules in relation to the provision of advice and recommendations which could create a situation where an auditor might review his or her own work or whether it would be permissible if it arose out of the normal course of an audit.
77. However, in addition to assessing the appropriateness of the service having regard to the general principles, it would be expected to consider all available SEC guidance (see paragraph 63 above). That would include, for example, an SEC release that recognizes that “obtaining an understanding of, assessing effectiveness of, and recommending improvements to the internal accounting and risk management controls is fundamental to the audit process and does not impair the accountant’s independence”<sup>46</sup> (emphasis added).
78. The PCAOB Interim Ethics and Independence Standard issued by the Independence Standard Board on the Impact on Auditor Independence of Assisting Clients in the Implementation of FAS 133 (Derivatives)<sup>47</sup> also includes “guidance on the auditor independence implications of likely areas of requested assistance, solely with respect to the implementation of FAS 133”. One category of services relates to the accounting application and the second involves valuation consulting services. The [PCAOB] has concluded that “the auditor may provide consulting services on the proper application of FAS 133, including assisting a client in gaining a general understanding of the methods, models, assumptions, and inputs used in computing a derivative’s value”.<sup>48</sup>

*Provision of NAS / Non-Audit Services Involving Other Threats*

79. Although the Code and the SEC rules have a similar approach in relation to the provision of NAS/non-audit services to an audit client, the Code does not include general prohibitions on the provision of services that would create threats other than self-review threat. Accordingly, in the case of NAS that would give rise to other threats, the framework of the SEC rules could be more restrictive, as described in paragraph 31-32.

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<sup>45</sup> Revised paragraph R600.17 of the Code

<sup>46</sup> Release No. 33-8183 (January 28, 2003), *Strengthening the Commission’s Requirements Regarding Auditor Independence*, Section II B 5.

<sup>47</sup> In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 133, “Accounting for Derivative Instruments and Hedging Activities” (FAS 133)

<sup>48</sup> ISB Interpretation 99-1 Interpretation 99-1 on Auditor Independence of Assisting Clients in the Implementation of FAS 133 (Derivatives)

### Advocating for an Audit Client

80. In 2021 IESBA introduced provisions prohibiting certain NAS that would create an advocacy threat but would not be prohibited on the basis that they give rise to a self-review threat, such as acting as an expert witness. In the case of PIE audit clients, the IESBA's view<sup>49</sup> is that the introduction of the self-review threat prohibition and the additional restrictions on the provision of NAS that might create an advocacy threat will reduce the types of NAS in respect of which a firm may be permitted to apply safeguards to reduce threats to independence to an acceptable level.

### Consideration of Materiality

81. Following the 2021 amendments to the NAS provisions of the Code, prohibitions on the provision of a NAS to a PIE audit client, including the "self-review threat" prohibition, apply regardless of the materiality of the outcome or results of the NAS on the financial statements on which the firm will express an opinion.<sup>50</sup>
82. The SEC rules take the same approach to the relevance of materiality. In its response to a frequently asked question (FAQ) the SEC Staff stated that "*materiality is not a basis upon which to overcome the presumption in making a determination that "it is reasonable to conclude that the results of the services will not be subject to audit procedures.*"<sup>51</sup>

### Provision of Services to Related Entities

83. The Code acknowledges that the provision of NAS to certain related entities of an audit client might not impair the auditor's independence. The SEC rules do not include such an acknowledgement.
84. Under the Code<sup>52</sup>, a firm or a network firm may provide NAS that would otherwise be prohibited to the following related entities of listed entities provided that specified conditions are satisfied, including in particular, that no self-review threat is created:
- An entity that has direct or indirect control over the client (i.e., parent entity);
  - 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; or
  - An entity which is under common control with the client (i.e., a sister entity).
85. The SEC rules provide that the provision of "five specific services" (bookkeeping, internal audit outsourcing, valuation services, actuarial services, financial information system design and implementation) causes the auditor to lack independence, "*unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements*" (the "not subject to audit" exception).<sup>53</sup>
86. The SEC and PCAOB rules do not explicitly exclude certain affiliates of audit clients from the scope of the restrictions of the provision of non-audit services to an audit client. However, the SEC has recognized that an example of a situation where it would be reasonable to conclude that the results of a specific service would not be subject to audit procedures would be where an

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<sup>49</sup> [Basis for Conclusions, Revisions to Non-Assurance Service Provisions in the Code](#)

<sup>50</sup> Revised paragraph 600.10 A2 of the Code

<sup>51</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, E - Non-audit Services [Question 3](#)

<sup>52</sup> Revised paragraph R600.26 of the Code

<sup>53</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (i) – (v)

accounting firm provides a prohibited service to an affiliate of the audit client, but the accounting firm is not the auditor of the entity or entities that control the accounting firm's audit client or its affiliate.<sup>54</sup>

87. Further, as part of an FAQ, the SEC Staff<sup>55</sup> noted that if separate entities under common control have autonomous financial and business operations, and the audit firm audits one of the entities, that audit firm may be able to apply the “not subject to audit” exception to entities that it does not audit. In that context, the SEC staff has not objected to the “not subject to audit” exception being applied in a private equity group context under similar circumstances. However, the SEC Staff added that the “not subject to audit” exception might not apply in other contexts, such as a traditional corporate entity or an investment company complex, depending on the particular facts and circumstances.
88. As the “not subject to audit” exception applies only to the “five specific services” listed in paragraph 85, the other non-audit services specifically addressed in the SEC<sup>56</sup> and PCAOB rules<sup>57</sup> - legal services, expert services unrelated to audit, management functions, corporate finance services, HR services and tax services – may not be provided to the affiliates of an audit client.

## **V. Provision Addressing Specific Non-Assurance/ Non-audit Services**

### **Accounting and Bookkeeping Services**

#### *Overall approach*

89. Both the Code and the SEC rules generally prohibit the provision of accounting and bookkeeping services by a firm to an audit client. Those prohibitions are based on the fact that provision of such services would place the firm in a position of auditing its own work and, if the service involved the preparation and fair presentation of the financial statements, the firm would be assuming management responsibility. In either case, the provision of the service would impair the auditor's independence.

#### *Exception to Prepare Statutory Financial Statements for a Related Entity/Affiliate*

90. As an exception to the general prohibition, the Code allows a firm to prepare the statutory financial statements for controlled related entities of an audit client where a local regulator requires the issuance of financial statements that are prepared in accordance with the applicable local legislation or regulation<sup>58</sup> provided that:
- The audit report on the group financial statements of the public interest entity has been issued;
  - The firm does not assume management responsibility and applies the conceptual framework to identify, evaluate and address threats to independence;

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<sup>54</sup> Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Footnote 51

<sup>55</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, E. Non-Audit Service [Question 5](#)

<sup>56</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (vi) – (X)

<sup>57</sup> PCAOB Standard 3522 and 3523

<sup>58</sup> Preparation of such statutory financial statements would not constitute the assumption of management responsibility because the firm would be required to use client-approved and client-prepared accounting records in preparing those statutory financial statements

- The firm does not prepare the accounting records underlying the statutory financial statements of the related entity and those financial statements are based on client approved information; and
  - The statutory financial statements of the related entity will not form the basis of future group financial statements of that public interest entity.<sup>59</sup>
91. The SEC adopts a similar approach where accountants are asked to prepare statutory financial statements for foreign companies provided those financial statements are not filed with the Commission<sup>60</sup>. The SEC's release stated<sup>61</sup> that "an accountant's independence would be impaired where the accountant prepared the statutory financial statements if those statements form the basis of the financial statements that are filed with us. Under these circumstances, an accountant or accounting firm who has prepared the statutory financial statements of an audit client is put in the position of auditing its own work when auditing the resultant U.S. GAAP financial statements."

## **Valuation Services**

### *General*

92. Valuation services in the Code are defined as services that involve making assumptions with regard to future developments, the application of appropriate methodologies and techniques and the combination of both to compute a certain value, or range of values, for an asset, a liability or for the whole or part of an entity.<sup>62</sup>
93. The SEC prohibits the provision of the following specific services to an audit client:
- Any appraisal service, valuation service, or any service involving a fairness opinion or contribution-in-kind report for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements<sup>63</sup>
  - Any actuarially-oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client other than assisting a client in understanding the methods, models, assumptions, and inputs used in computing an amount unless it is reasonable to conclude that the results of such services will not be subject to audit procedures during an audit of the audit client's financial statements.<sup>64</sup>
94. Appraisal and valuation services include any process that involves valuing assets, both tangible and intangible, or liabilities – such as in-process research and development, financial instruments, assets and liabilities acquired in a merger, and real estate. Fairness opinions and contribution-in-kind reports are opinions and reports in which the firm provides its opinion on the adequacy of consideration in a transaction.<sup>65</sup>

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<sup>59</sup> Revised paragraph R601.7 of the Code

<sup>60</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II B 1.

<sup>61</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II B 1.

<sup>62</sup> Revised paragraph 603.2 A1 of the Code

<sup>63</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (iii)

<sup>64</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01(c) (4) (iv)

<sup>65</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II B 3.

95. Valuation services to assist an audit client with tax reporting obligations or for tax planning purposes where the results of the valuation have no effect on the accounting records or the financial statements is considered in paragraphs 121 to 124 below.

#### *Prohibited Valuation Services*

96. Both the Code<sup>66</sup> and the SEC rules<sup>67</sup> prohibit valuation services that might create self-review threat/ places the auditor in a position of auditing its own work.
97. Under the Code, if a valuation service does not create a self-review threat but might create an advocacy threat, a firm may provide the service to an audit client, provided that safeguards are applied to reduce the advocacy threat to an acceptable level and provided other applicable provisions in the Code are complied with.
98. Based on the general prohibition on serving as an advocate for an audit client, the SEC rules<sup>68</sup> prohibit the provision of all valuation services to an audit client that could give rise to an advocacy threat.

#### Commentary

99. Although the SEC/PCAOB's prohibition focuses on specific services, the objectives of the prohibitions in the Code and in the SEC, rules appear to be the same, namely, to prohibit a firm from undertaking a valuation procedure, the outcome of which will affect the accounting records or the financial statements on which the firm will express an opinion and so result in the firm auditing its own work.
100. In relation to valuation services that give rise to advocacy threat - despite the conceptually different approaches described in paragraph 31-32 - the "self-review threat prohibition" significantly limits the types of valuation services in respect of which a firm may be permitted to apply safeguards to reduce threats to independence. Consequently, the outcome under the Code is not substantively different from that under the SEC rules.

#### **Administrative Services**

101. The Code permits the provision of administrative services that involve firms assisting audit clients with routine or mechanical tasks within the normal course of operations unless a self-review threat might be created.<sup>69</sup> The Code's approach is based on the fact that the definition of administrative services requires the services to be clerical in nature and to require little to no professional judgment.<sup>70</sup>
102. The SEC and PCAOB rules do not address the provision of administrative services to an audit client. However, the SEC rules prohibit a firm from acting as management, which includes acting as an employee of an audit client (see paragraph 38.) The firm would therefore need to be

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<sup>66</sup> Revised paragraph 603.5 of the Code

<sup>67</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (iii)-(iv)

<sup>68</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (b)

<sup>69</sup> Revised paragraph 602.2 A2 provides the following examples of administrative services:

- Word processing or document formatting.
- Preparing administrative or statutory forms for client approval.
- Submitting such forms as instructed by the client.
- Monitoring statutory filing dates and advising an audit client of those dates.

<sup>70</sup> Revised paragraph 602.2 A1 of the Code

satisfied that the provision of the admin service would not place the firm in a position of acting as an employee of its audit client.

## **Tax Services**

### *General*

103. As tax gives rise to a broad range of services that are often interrelated in practice and may be combined with other types of services, such as corporate finance services, provided by a firm to an audit client, the Code does not define “tax services”<sup>71</sup> and does not contain any general provisions addressing the prohibition or permissibility of providing tax services to an audit client. Consequently, following the approach in the conceptual framework, if a tax service is not explicitly prohibited by the Code, a firm is permitted to deliver that service, provided that the general requirements of the Code are complied with.
104. The Code does, however, explicitly prohibit the provision of the following tax services by a firm to a PIE audit client:
- Calculations of current/deferred taxes for the purpose of preparing accounting entries that support such balances
  - Tax advice that depends on a particular accounting treatment/financial statement presentation with respect to which there is reasonable doubt as to its appropriateness,
  - Acting as an advocate before a tribunal or court to resolve a tax matter,
  - Valuation for tax purposes if it might create a self-review threat,
  - Tax advisory and tax planning services if it might create a self-review threat, and
  - Assistance in the resolution of tax disputes if it might create a self-review threat.
105. The SEC rules are silent in relation to the provision of tax services. However, an SEC release explains that: “the Commission reiterates its long-standing position that an accounting firm can provide tax services to its audit clients without impairing the firm's independence. Accordingly, accountants may continue to provide tax services such as tax compliance, tax planning, and tax advice to audit clients, subject to the normal audit committee pre-approval requirements under 2-01(c)(7)”. The SEC’s release also adds that: “nevertheless, merely labeling a service as a “tax service” will not necessarily eliminate its potential to impair independence under Rule 2-01(b) Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant.”<sup>72</sup>
106. The PCAOB has developed standards addressing the provision of tax services to audit clients which supplements the application of the SEC’s general independence standards. PCAOB Rules 3522<sup>73</sup> and 3523<sup>74</sup> are designed to address potential ethical problems posed by firms’ involvement in two areas

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<sup>71</sup> Revised paragraph 604.2 A1 of the Code

<sup>72</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II B 11.

<sup>73</sup> PCAOB Rule 3522. Tax Transactions. These rules apply to audits of issuers and broker-dealers.

<sup>74</sup> PCAOB Rule 3523. Tax Services for Persons in Financial Reporting Oversight Roles. These rules apply to audits of issuers.



- Advice on tax positions that may be abusive (confidential transactions and aggressive tax positions transactions), and
- Tax compliance and planning services for certain senior officers, i.e., those in a financial reporting oversight role.<sup>75</sup>

#### *Aggressive Tax Positions and Confidential Transactions*

107. The 2021 revisions to the Code prohibit firms from providing a tax service or recommending a transaction to an audit client if the service or transaction relates to marketing, planning, or opining in favor of a tax treatment that was initially recommended, directly or indirectly, by the firm or network firm, and a significant purpose of the tax treatment or transaction is tax avoidance unless the firm is confident that the proposed treatment has a basis in applicable tax law or regulation that is likely to prevail.<sup>76</sup>
108. PCAOB Rule 3522<sup>77</sup> provides that “the registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period, provides any non-audit service to the audit client related to marketing, planning, or opining in favor of the tax treatment of, a transaction -
- Confidential Transactions - that is a confidential transaction; or
  - Aggressive Tax Position Transactions - that was initially recommended, directly or indirectly, by the registered public accounting firm and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws”.

#### *Commentary*

109. Whilst both frameworks prohibit the provision of aggressive tax advice and transactions<sup>78</sup>, the Code does not include a prohibition on the provision of a confidential transaction<sup>79</sup> to an audit client. *[To be developed further]*

#### *Specific Tax Services Provided to an Audit Client*

##### *Tax Return Preparation*

110. Provided that the general provisions of the Code applicable to services provided to PIE audit clients are met, including the “self-review threat prohibition”, the Code does not prohibit the provision of tax return preparation services to an audit client because:
- Tax return preparation services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice; and

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<sup>75</sup> To the extent that auditors’ provision of other tax services is consistent with the SEC’s independence requirements, the PCAOB rules would not prohibit accounting firms from providing those services to their audit clients, subject to the SEC’s requirements relating to audit committee pre-approval of such services

<sup>76</sup> Revised paragraph R604.4 of the Code

<sup>77</sup> PCAOB Rule 3522. Tax Transactions

<sup>78</sup> Note: the IESBA’s prohibition is applicable to all audit clients, not only to PIEs or listed entities.

<sup>79</sup> Based on PCAOB Rule 3501 (c)(i) (1), a “confidential transaction” is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a fee.

- Tax returns are subject to whatever review or approval process the tax authority considers appropriate.<sup>80</sup>

111. The PCAOB's position<sup>81</sup> is that "as a general matter, routine tax return preparation and tax compliance services have not raised independence concerns. In the case of most tax compliance services, the auditor does not prepare tax returns until after management has calculated and allocated its tax liability and the auditor has audited the income tax accounts to obtain reasonable assurance that they are fairly stated and are accompanied by appropriate disclosure. Also, in preparing a tax return, the auditor is not acting as an advocate for its client".

#### *Tax Calculations*

112. The Code and the SEC rules do not contain general provisions governing the provision of tax calculations to audit clients.

113. The Code does, however, explicitly prohibit the provision of calculations of current and deferred tax liabilities (or assets) to an audit client for the purpose of preparing accounting entries that support such balances because such calculations create a self-review threat.<sup>82</sup>

#### *Commentary*

114. Whilst the SEC rules contain no such explicit prohibition, the application of the SEC's principles that a firm is prohibited from auditing its own work and acting as management are likely to result in the same outcome.

#### *Tax advisory and Tax Planning*

115. The Code does not contain a general prohibition on the provision of tax advisory or tax planning services to an audit client unless the purpose of the tax advice is tax avoidance (see paragraphs 107 to 109 above).<sup>83</sup>

116. However, the Code prohibits tax advisory and tax planning services:

- That would result in a firm assuming a management responsibility;
- Where the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements, and the audit team has doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework<sup>84</sup>;
- That might create a self-review threat.<sup>85</sup>

117. If provision of the service will not create a self-review threat, but might create an advocacy threat, a firm may provide the service if safeguards can be applied to reduce any advocacy threat to an acceptable level.<sup>86</sup>

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<sup>80</sup> Revised paragraph 604.6 A1 of the Code

<sup>81</sup> PCAOB Release No. 2004-015 (December 14, 2004)

<sup>82</sup> Revised paragraphs 604.8 A1 and R604.10 of the Code

<sup>83</sup> This approach is based on the fact that tax advisory and tax planning services comprise a broad range of services, including advising the audit client how to structure its affairs in a tax-efficient manner or advising on the application of a tax law or regulation (Revised paragraph 604.11 A1 of the Code)

<sup>84</sup> Revised paragraph R604.13 of the Code

<sup>85</sup> Revised paragraph R604.15 of the Code

<sup>86</sup> Revised paragraph 604.15 A1 of the Code

118. Provided that aggressive tax strategies are not adopted, which is the subject of a specific prohibition (see paragraphs 107 to 109 above), the PCAOB<sup>87</sup> stated that the provision of tax advisory or tax planning services to audit clients should not be prohibited, provided that the audit client makes the decisions relating to, and takes responsibility for, both the tax work and the presentation of tax related accounts and other matters in the financial statements. This conclusion was based on research showing that tax planning in connection with routine and even non-routine business transactions initiated by the audit client has not given rise to auditor independence concerns.
119. Although the SEC rules do not contain specific prohibitions in this area, an SEC release<sup>88</sup> states that “merely labeling a service as a “tax service” will not necessarily eliminate its potential to impair independence under Rule 2-01(b). Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant.”.

#### Commentary

120. Unlike the Code, the SEC rules do not allow the application of any safeguards if the provision of tax advisory and tax planning services puts the auditor in an advocacy role. Despite the conceptually different approaches described in paragraphs 31-32, the combination of the “self-review threat prohibition” and the explicit prohibitions on services that create an advocacy threat significantly limits the types of services in respect of which a firm may be permitted to apply safeguards to reduce threats to independence. Consequently the outcome under the Code result is not substantively different from the outcome under the SEC rules.

#### *Tax services involving valuations*

121. The provision of tax services which involve valuations can arise in a range of circumstances, including (i) merger and acquisition transactions, (ii) group restructurings and corporate reorganizations, (iii) transfer pricing studies, (iv) stock-based compensation arrangements.<sup>89</sup> Such services might create a self-review threat and advocacy threat.<sup>90</sup>
122. The Code prohibits the provision of tax services involving valuations to an audit client if they might create a self-review threat.<sup>91</sup> No such prohibition exists if such services create only an advocacy threat and the Code permits a firm to apply safeguards, if available, to reduce the advocacy threat to an acceptable level.<sup>92</sup>
123. The SEC’s release states<sup>93</sup> that the “rules do not prohibit an accounting firm from providing such services [*appraisal or valuation services, fairness opinions, or contribution-in-kind reports*] for non-financial reporting (e.g., transfer pricing studies, cost segregation studies, and other tax-only valuations) purpose”.

#### Commentary

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<sup>87</sup> PCAOB Release No. 2004-015 (December 14, 2004)

<sup>88</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission’s Requirements Regarding Auditor Independence, Section II B 11.

<sup>89</sup> Revised paragraph 604.16 A1 of the Code

<sup>90</sup> Revised paragraph 604.17 A1 of the Code

<sup>91</sup> Revised paragraph R604.19 of the Code

<sup>92</sup> Revised paragraph 604.19 A1 of the Code

<sup>93</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission’s Requirements Regarding Auditor Independence, Section II B 3.

124. The provision of the tax services involving valuations to an audit client when such service might create a self-review threat is explicitly prohibited under the Code. The SEC rules do not prohibit tax services that involve valuations. However, before providing such a service, the auditor is required to consider the general independence standards and principles. If a firm concludes that a service would result in the firm auditing its own work, it would not be permissible under the SEC rules. In the case of services that give rise only to advocacy threats please refer to paragraph 100.

*Assistance in the resolution of tax disputes*

125. A firm may be asked to assist an audit client in the resolution of a tax dispute, for example, where a tax authority has notified an audit client that arguments on a particular issue have been rejected and the tax authority or the client refers the matter for determination in a formal proceeding before a tribunal or court.<sup>94</sup>
126. Under the Code, a firm is prohibited from assisting an audit client in the resolution of tax disputes if the provision of that assistance might create a self-review threat.<sup>95</sup> No such prohibition exists if such services create only an advocacy threat and the Code permits a firm to apply safeguards, if available, to reduce the advocacy threat to an acceptable level.<sup>96</sup>
127. The Code specifically prohibits a firm from acting for a PIE audit client as an advocate before a tribunal or court.<sup>97</sup> However, a firm may act in an advisory role in relation to the matter that is being heard before a tribunal or court by, for example, responding to specific requests for information, providing factual accounts or testimony about the work performed, or assisting the client in analyzing the tax issues related to the matter<sup>98</sup>.
128. The SEC rules do not include specific prohibitions regarding the provision of assistance in tax disputes. However, the SEC's release<sup>99</sup> sets out that "merely labeling a service as a "tax service" will not necessarily eliminate its potential to impair independence under Rule 2-01(b). Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant. Specifically, accountants would impair their independence by representing an audit client before a tax court, district court, or federal court of claims".

*Commentary*

129. Both the Code and the SEC rules prohibit firms from representing an audit client in tax matters before a tribunal or court. However, unlike the Code, the SEC rules do not allow firms to act in an advisory role in relation to a tax matter that is being heard before a tribunal or court.

*Tax Services Provided to Senior Officers of the Audit Client*

130. PCAOB Rule 3523<sup>100</sup> prohibits a firm from providing a tax service to a person in a financial reporting oversight role at an issuer audit client, or an immediate family member of such

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<sup>94</sup> Revised paragraph 604.20 A1 of the Code

<sup>95</sup> Revised paragraph R604.24 of the Code

<sup>96</sup> Revised paragraph 604.24 A1 of the Code

<sup>97</sup> Revised paragraph R604.26 of the Code

<sup>98</sup> Revised paragraph 604.27 A1 of the Code

<sup>99</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 11

<sup>100</sup> PCAOB Rule 3523. Tax Services for Persons in Financial Reporting Oversight Roles

person.<sup>101</sup> The PCAOB issued the Rule to address concern that performing tax services for certain individuals involved in the financial reporting processes of an audit client creates an appearance of a mutual interest between the auditor and those individuals.<sup>102</sup>

#### Commentary

131. The Code does not include an equivalent provision. However, the general provisions applicable to self-interest threats created would apply and a firm would be expected to consider whether the provision of tax services to a person in a financial reporting oversight role at an audit client might compromise the firm's judgment.

#### Internal Audit Services

132. The provision of internal audit services to an audit client may

- result in a firm (or network firm) assuming a management responsibility (see paragraph 38). The Code provides examples of internal audit activities that are prohibited because they would result in a firm assuming management responsibility.<sup>103</sup>
- create a self-review threat because in relation to the audit of the financial statements on which the firm will express an opinion.<sup>104</sup> The Code prohibits firms from providing internal audit services to a PIE audit client if the provision of such services might create a self-review threat.<sup>105</sup>

As internal audit services may involve matters that are operational in nature, they do not necessarily relate to matters that will be subject to consideration in relation to the audit of the financial statements and therefore create a self-review threat.<sup>106</sup>

133. However, the Code includes examples of services that would create a self-review threat, namely services that relate to (i) the internal controls over financial reporting, (ii) financial accounting systems that generate information for the client's accounting records or financial statements on which the firm will express an opinion, or (iii) amounts or disclosures that relate to the financial statements on which the firm will express an opinion.<sup>107</sup>

134. Similar to the Code's approach, the SEC rules prohibit providing any internal audit services outsourced by an audit client that relates to the audit client's internal accounting controls, financial

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<sup>101</sup> The PCAOB rule is not applicable to a person in a financial reporting role if:

- a) the person is in a financial reporting oversight role at the issuer audit client only because he or she serves as a member of the board of directors or similar management or governing body of the audit client;
- b) the person is in a financial reporting oversight role at the issuer audit client only because of the person's relationship to an affiliate of the entity being audited
  - (1) whose financial statements are not material to the consolidated financial statements of the entity being audited; or
  - (2) whose financial statements are audited by an auditor other than the firm or an associated person of the firm; or
- c) the person was not in a financial reporting oversight role at the issuer audit client before a hiring, promotion, or other change in employment event and the tax services are
  - (1) provided pursuant to an engagement in process before the hiring, promotion, or other change in employment event; and
  - (2) completed on or before 180 days after the hiring or promotion event.

<sup>102</sup> PCAOB Release No. 2005-014 July 26, 2005

<sup>103</sup> Revised 605.3 A2 of the Code

<sup>104</sup> Revised 605.4 A1 of the Code

<sup>105</sup> Revised R605.6 of the Code

<sup>106</sup> Revised 605.2 A2 of the Code

<sup>107</sup> Revised 605.6 A1 of the Code

systems, or financial statements, for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.<sup>108</sup>

135. Both the Code<sup>109</sup> and the SEC's releases<sup>110</sup> recognize that firms should be able to provide advice and recommendations in relation to matters that they identify in the course of an audit relating to the audit client's internal controls.

#### Commentary

136. Overall, the frameworks of the Code and the SEC intend to prohibit the provisions of the same type of internal audit services to an audit client.

#### Information Technology (IT) System Services

137. The provision of IT system services to an audit client might (i) result in a firm assuming management responsibility or (ii) create a self-review threat if there is a risk that the results of the services will affect the audit of the financial statements on which the firm will express an opinion.<sup>111</sup>

138. The Code prohibits the provision of IT systems services to a PIE audit client if those services might create a self-review threat.<sup>112</sup> Examples of services that may create a self-review threat include those involving designing or implementing IT systems that:

- a) Form part of the internal control over financial reporting; or
- b) Generate information for the client's accounting records or financial statements on which the firm will express an opinion.<sup>113</sup>

139. Similarly, the SEC issued a release stating that "designing, implementing, or operating systems affecting the financial statements may place the accountant in a management role, or result in the accountant auditing his or her own work or attesting to the effectiveness of internal control systems designed or implemented by that accountant".<sup>114</sup>

140. Consequently, the SEC rules prohibit a firm from providing "any service [*related to the financial information systems design and implementation*] unless it is reasonable to conclude that the

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<sup>108</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (v)

<sup>109</sup> Revised R600.17 of the Code

<sup>110</sup> Despite the above-mentioned prohibition, the SEC's release includes that "during the conduct of the audit in accordance with generally accepted auditing standards ("GAAS") or when providing attest services related to internal controls, the auditor evaluates the company's internal controls and, as a result, may make recommendations for improvements to the controls. Doing so is a part of the accountant's responsibilities under GAAS or applicable attestation standards and, therefore, does not constitute an internal audit outsourcing engagement" Furthermore, the SEC's release added that "along those lines, this prohibition on "outsourcing" does not preclude engaging the accountant to perform nonrecurring evaluations of discrete items or other programs that are not in substance the outsourcing of the internal audit function. For example, the company may engage the accountant, subject to the audit committee pre-approval requirements, to conduct "agreed-upon procedures" engagements related to the company's internal controls, since management takes responsibility for the scope and assertions in those engagements. The prohibition also does not preclude the accountant from performing operational internal audits unrelated to the internal accounting controls, financial systems, or financial statements. (No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 5)

<sup>111</sup> Revised 606.4 A1 of the Code

<sup>112</sup> Revised R606.6 of the Code

<sup>113</sup> Revised 606.6 A1 of the Code

<sup>114</sup> Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 2

results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:

(A) Directly or indirectly operating, or supervising the operation of, the audit client's information system or managing the audit client's local area network; or

(B) Designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the audit client's financial statements or other financial information systems taken as a whole".<sup>115</sup>

141. Like the Code, the SEC's release also stated that "such rules do not preclude an accounting firm from working on hardware or software systems that are unrelated to the audit client's financial statements or accounting records as long as those services are pre-approved by the audit committee".<sup>116</sup>
142. The SEC's release further stated that "this prohibition does not preclude the accountant from evaluating the internal controls of a system as it is being designed, implemented or operated either as part of an audit or attest service and making recommendations to management. Likewise, the accountant would not be precluded from making recommendations on internal control matters to management or other service providers in conjunction with the design and installation of a system by another service provider".<sup>117</sup>
143. The SEC's release is, therefore, in line with the Code's approach of not prohibiting the provision of advice and recommendations that might create a self-review threat if such advice and recommendations arise out of the normal course of an audit as described in paragraph 75 above.

#### *Commentary*

144. Overall, the Code and the SEC address the same concerns in substantially the same manner.

#### **Litigation Support Services**

145. Litigation support services include, for example, (i) assisting with document management and retrieval; (ii) acting as a witness, including an expert witness; (iii) calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute; or (iv) forensic or investigative services.<sup>118</sup>
146. Providing litigation support services to an audit client might create a self-review threat or an advocacy threat. The Code prohibits the provision of litigation support services to a PIE audit client if it might create a self-review threat<sup>119</sup>. The provision of advice in connection with a legal proceeding the outcome of which may affect the quantification of a provision or other amount in the financial statements on which the firm will express an opinion is an example of a service that creates a self-review threat.<sup>120</sup>
147. Litigation support services may also create advocacy threats. The Code does not explicitly prohibit the provision of litigation services that might create an advocacy threat – other than acting

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<sup>115</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (ii)

<sup>116</sup> Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 2

<sup>117</sup> Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 2

<sup>118</sup> Revised 607.2 A1 of the Code

<sup>119</sup> Revised R607.6 of the Code

<sup>120</sup> Revised 607.6 A1 of the Code



- as an expert witness - provided that the firm ensures that the level of such threat is at an acceptable level.<sup>121</sup>
148. The Code addresses the position where a firm, or an individual within a firm, acts as a witness for an audit client. The Code distinguishes between giving evidence to a tribunal or court as a witness of fact or as an expert witness.<sup>122</sup>
149. Under the Code<sup>123</sup>, a firm is permitted to act for an audit client as an expert witness, if it is:
- (a) Appointed by a tribunal or court to act as an expert witness in a matter involving a client; or
  - (b) Engaged to advise or act as an expert witness in relation to a class action (or an equivalent group representative action) provided that:
    - (i) The firm's audit clients constitute less than 20% of the members of the class or group (in number and in value);
    - (ii) No audit client is designated to lead the class or group; and
    - (iii) No audit client is authorized by the class or group to determine the nature and scope of the services to be provided by the firm or the terms on which such services are to be provided.
150. The SEC rules prohibit the provision of an expert opinion or other expert service for an audit client, for the purpose of advocating an audit client's interests in litigation or in a regulatory or administrative proceeding or investigation. A firm is also prohibited from providing such services to an audit client's legal representative.<sup>124</sup> An SEC's release explains<sup>125</sup> that although all services provided by an accountant may be perceived to be expert services, this prohibition only applies to services that involve advocacy in proceedings and investigations and does not apply to other permitted non-audit services, such as tax services.
151. Like the Code, the SEC rules make it clear that a firm's independence is not impaired if it firm provides factual accounts, including in testimony, of work performed or explains the positions taken or conclusions reached during the performance of any service provided by the accountant for the audit client.<sup>126</sup> However, the SEC rules do not provide an exception if the witness is appointed by the court or engaged in relation to a class action, as in the case of the Code.
152. An SEC's release also stated that the SEC rules "do not preclude an audit committee or, at its direction, its legal counsel, from engaging the firm to perform internal investigations or fact-finding engagements. These types of engagements may include, among others, forensic or other fact-finding work that results in the issuance of a report to the audit client".<sup>127</sup>

### *Commentary*

153. The SEC's restrictions in relation to litigation support services are broader than the Code's prohibitions as they

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<sup>121</sup> Revised 607.6 A2 of the Code

<sup>122</sup> Revised 607.7 A1 of the Code

<sup>123</sup> Revised 607.7 A3 and R607.9 of the Code

<sup>124</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (x)

<sup>125</sup> Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Footnote 97;

<sup>126</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (x)

<sup>127</sup> Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II. B 10

- prohibit the provision of any kind of expert services for the purpose of advocating an audit client's interest.<sup>128</sup>
- do not permit the provision of litigation services to affiliates of an audit client. In contrast, the Code allows the provision of prohibited litigation support services to related entities provided certain conditions are met (see paragraph 88 above).

### **Legal Services**

154. Legal services are defined in the Code as those services for which the individual providing the services must either:
- Have the required legal training to practice law; or
  - Be admitted to practice law before the courts of the jurisdiction in which such services are to be provided.<sup>129</sup>
155. The Code does not contain a general prohibition on the provision of legal services to an audit client. In the case of PIE audit clients, the Code prohibits:
- Provision of legal advice if it might create a self-review threat.<sup>130</sup>
  - A partner or employee of the firm or the network firm serving as General Counsel of an audit client<sup>131</sup>
  - Acting in an advocacy role for an audit client in resolving a dispute or litigation before a tribunal or court<sup>132</sup>
156. The SEC rules prohibit the provision of any service to an audit client that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided.<sup>133134</sup>

### *Commentary*

157. The Code focuses only on specific types of legal services and does not establish a general prohibition on the provision of legal services by firms to their audit clients. The Code also permits

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<sup>128</sup> In situations involving advocacy, the provision of expert services by the accountant makes the accountant part of the "team" that has been assembled to advance or defend the client's interests. The appearance of advocacy created by providing such expert services is sufficient to deem the accountant's independence impaired. The prohibition on providing "expert" services included in this rule covers engagements that are intended to result in the accounting firm's specialized knowledge, experience and expertise being used to support the audit client's positions in various adversarial proceedings. (Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II. B 10)

<sup>129</sup> Revised 608.2 A1 of the Code

<sup>130</sup> Revised R608.7 of the Code

<sup>131</sup> Revised R608.9 of the Code

<sup>132</sup> Revised R608.11 of the Code

<sup>133</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (ix)

<sup>134</sup> The SEC stated that: "We believe that a lawyer's core professional obligation is to advance clients' interests. Rules of professional conduct in the U.S. require the lawyer to "represent a client zealously and diligently within the bounds of the law." The lawyer must "take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor. . . . In the exercise of professional judgment, a lawyer should always act in a manner consistent with the best interests of the client." We have long maintained that an individual cannot be both a zealous legal advocate for management or the client company, and maintain the objectivity and impartiality that are necessary for an audit." (Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II. B 9)

the provision of prohibited legal services to affiliates of an audit client provided that certain conditions are met (see paragraph 88 above).

158. By contrast, the SEC rules prohibit the provision of legal services to an audit client or to any affiliate of that audit client.

### **Recruiting Services**

159. The provision of recruiting services to an audit client (i) might result in a firm assuming management responsibility and (ii) might create a self-interest, familiarity or intimidation threat.<sup>135</sup>

160. Although the Code does not set out a general prohibition, it restricts firms from providing the following recruiting services to an audit client

- Acting as a negotiator on the client's behalf, and<sup>136</sup>
- Services that relates to<sup>137</sup>:
  - (a) Searching for or seeking out candidates;
  - (b) Undertaking reference checks of prospective candidates;
  - (c) Recommending the person to be appointed; or
  - (d) Advising on the terms of employment, remuneration or related benefits of a particular candidate,

with respect to the following positions:

- (i) A director or officer of the entity; or
- (ii) 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.

161. However, the Code acknowledges that provision of the following services to an audit client does not usually create a threat to a firm's independence:

- Reviewing the professional qualifications of a number of applicants and providing advice on their suitability for the position.
- Interviewing candidates and advising on a candidate's competence for financial accounting, administrative or control positions.

162. The SEC's release explains that "assisting management in human resource selection or development places the accountant in the position of having an interest in the success of the employees that the accountant has selected, tested, or evaluated. Accordingly, observers may perceive that an accountant would be reluctant to suggest the possibility that those employees failed to perform their jobs appropriately, or at least reasonable investors might perceive the accountant to be reluctant, because doing so would require the accountant to acknowledge shortcomings in its human resource service. The accountant also might have other incentives not

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<sup>135</sup> Revised R609.3 and 609.4 A1 of the Code

<sup>136</sup> Revised R609.5 of the Code

<sup>137</sup> Revised R609.6 of the Code

to report such employees' ineffectiveness, including that the accountant would identify and be identified with the recruited employees".<sup>138</sup>

163. Consequently, the SEC rules prohibit the following human resources services<sup>139</sup>:

- Searching for or seeking out prospective candidates for managerial, executive, or director positions;
- Engaging in psychological testing, or other formal testing or evaluation programs;
- Undertaking reference checks of prospective candidates for an executive or director position;
- Acting as a negotiator on the audit client's behalf, such as determining position, status or title, compensation, fringe benefits, or other conditions of employment; or
- Recommending, or advising the audit client to hire, a specific candidate for a specific job (except that an accounting firm may, upon request by the audit client, interview candidates and advise the audit client on the candidate's competence for financial accounting, administrative, or control positions).<sup>140</sup>

#### *Commentary*

164. The prohibitions regarding recruiting/ human resources services in the SEC rules and in the Code mainly cover the same types of services, with a few minor differences; for example:

- The SEC rules prohibit firms from engaging in psychological testing, or other formal testing or evaluation programs for the audit client. In contrast, these services are not explicitly prohibited under the Code's provisions.
- While the SEC rules prohibit a firm from recommending or advising an audit client to hire a specific candidate for any kind of job, the equivalent Code prohibition applies only in respect of such services only in relation to the director, officers, or specific member of senior management.

#### **Corporate Finance Services**

165. The Code provides that the provision of corporate finance services<sup>141</sup> by a firm to an audit client may result in the firm assuming management responsibility, and might create a self-review threat.<sup>142</sup>

166. As a result, the Code prohibits firms from providing to an audit client:

- Corporate finance services that involve promoting, dealing in, or underwriting the shares, debt or other financial instruments issued by the audit client or providing advice on investment in such shares, debt or other financial instruments;<sup>143</sup>
- Advice in relation to corporate finance services where:
  - (a) The effectiveness of such advice depends on a particular accounting treatment or presentation in the financial statements on which the firm will express an opinion; and

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<sup>138</sup> No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 7

<sup>139</sup> Although the Code's provision construe "recruiting services", while the SEC/PCAOB rules "human resources services", the IESBA Staff is of the view that the determination of these services is the same in the two frameworks.

<sup>140</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (viii)

<sup>141</sup> Revised 610.2 A1 of the Code

<sup>142</sup> Revised 610.3 A1 of the Code

<sup>143</sup> Revised R610.5 of the Code

- (b) The audit team has doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework;<sup>144</sup>
- Corporate finance services, if the provision of such services might create a self-review threat.<sup>145</sup>
167. Apart from the risk of assuming management responsibility and the self-review threat, the Code also states that the provision of corporate finance services might create an advocacy threat. The Code does not prohibit services that only create an advocacy threat provided the firm applies safeguards to address such threats.<sup>146</sup>
168. The SEC rules address explicitly: (i) broker-dealer, (ii) investment adviser, and (iii) investment banking services, and prohibit firms from:
- Acting as a broker-dealer (registered or unregistered), promoter, or underwriter, on behalf of an audit client,
  - Making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments,
  - Executing a transaction to buy or sell an audit client's investment, or
  - Having custody of assets of the audit client, such as taking temporary possession of securities purchased by the audit client.<sup>147</sup>
169. The SEC's approach is based on a view that "selling - directly or indirectly - an audit client's securities is incompatible with the accountant's responsibility of assuring the public that the company's financial condition is fairly presented. When an accountant, in any capacity, recommends to anyone (including non-audit clients) that they buy or sell the securities of an audit client or an affiliate of the audit client, the accountant has an interest in whether those recommendations were correct. That interest could affect the audit of the client whose securities, or whose affiliate's securities, were recommended."<sup>148</sup>
170. Furthermore, "broker-dealers often give advice and recommendations on investments and investment strategies. The value of that advice is measured principally by the performance of a customer's securities portfolio. When the customer is an audit client, the accountant has an interest in the value of the audit client's securities portfolio, even as the accountant must determine whether management has properly valued the portfolio as part of an audit. Thus, the accountant would be placed in a position of auditing his or her own work. Furthermore, the accountant is placed in a position of acting as an advocate on behalf of the client."<sup>149</sup>

#### Commentary

171. Both frameworks prohibit corporate finance services that involve promoting, dealing in, or underwriting the shares, debt or other financial instruments issued by the audit client – including acting as a broker-dealer - or providing advice on investment.

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<sup>144</sup> Revised R610.6 of the Code

<sup>145</sup> Revised R610.6 of the Code

<sup>146</sup> Revised 610.3 A1 and 610.8 A1 of the Code

<sup>147</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (viii)

<sup>148</sup> No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 8

<sup>149</sup> No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 8

172. In relation to other types of corporate finance service, the Code relies on the application of general principles. The SEC rules focus on a number of specific prohibited services.<sup>150</sup> For example, the SEC prohibits having custody of assets of the audit client. While the Code does not include such a prohibition, firms have to apply the conceptual framework to determine whether such service is permissible or not under the particular circumstances.
173. In relation to corporate finance services that give rise to advocacy threat - despite the conceptually different approaches described in paragraphs 31-32 - the “self-review threat prohibition” significantly limits the types of services in respect of which a firm may be permitted to apply safeguards to reduce threats to independence. Consequently, the outcome under the Code is not substantively different from that under the SEC rules. *[To be further developed]*

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<sup>150</sup> Revised 610.2 A1 of the Code