

## Draft Minutes of the Teleconference of the IESBA Consultative Advisory Group (CAG)

Held on November 18, 2014

(MARK-UP)

### *Present:* **Representatives of Member Organizations**

Kristian Koktvedgaard (Chair)	Business Europe
James Dalkin	International Organisation of Supreme Audit Institutions (INTOSAI)
Lucy Elliott	Organization for Economic Cooperation and Development (OECD)
Seiya Fukushima	International Organization of Security Commissions (IOSCO)
Harrison Greene	Basel Committee on Banking Supervision (BCBS)
Gaylen Hansen	National Association of State Boards of Accountancy (NASBA)
Marie Hollein	North American Financial Executives Institute
Jean-Luc Michel	European Federation of Financial Executives' Institutes (EFFEI)
Patricia Miller	Institute of Internal Auditors (IIA)
Noémi Robert	Fédération des Experts Comptables Européens (FEE)
Myles Thompson	FEE
Matthew Waldron	CFA Institute
Gamini Wijesinghe	Sri Lanka Accounting and Auditing Standards Monitoring Board

### **Observers**

Chandu Bhawe	Public Interest Oversight Board (PIOB)
Dr. Stavros Thomadakis	Incoming IESBA Chairman

### **IESBA**

Wui San Kwok	Interim IESBA Chair
Gary Hannaford	IESBA Member and NAS Task Force Chair

### **IESBA Staff**

Ken Siong	Technical Director
Jason Evans	Project Staff

<i>Regrets:</i> Jaseem Ahmed	Islamic Financial Services Board
Obaid Saif Hamad Al Zaabi	Gulf States Regulatory Authorities

Dr. Juan Maria Arteagoitia	European Commission (EC)
Martin Baumann	U.S. Public Company Auditing Oversight Board (PCAOB)
Linda de Beer	World Federation of Exchanges and IAASB CAG
Brian Bluhm	IFAC Small and Medium Practices (SMP) Committee
Vania Borgerth	Associacao Brasileira de Instituicoes Financeiras de Desenvolvimento (ABDE)
Tom Finnell	International Association of Insurance Supervisors (IAIS)
Nigel James	IOSCO
Marie Lang	European Federation of Accountants and Auditors for SMEs
Irina Lopez	World Bank
Conchita Manabat	Asian Financial Executives Institutes
Anne Molyneux	International Corporate Governance Network (ICGN)

**A. Opening Remarks**

Mr. Koktvedgaard welcomed all participants to the teleconference. He welcomed in particular the incoming IESBA Chairman, Dr. Stavros Thomadakis, noting that there would be opportunity for in-person introductions at the March 2015 CAG meeting. Mr. Koktvedgaard then outlined the purpose of the call.

The minutes of the September 2014 CAG meeting were approved subject to a minor editorial change.

**B. Non-Assurance Services**

Mr. Hannaford introduced the topic, recapping the background to, and scope of, the project, and the process the Board had followed to date. He provided an overview of the responses to the exposure draft (ED) and the significant comments from respondents. He then outlined the Task Force's proposed changes to the ED based on the comments received, noting that these changes had been discussed at the October 2014 IESBA meeting.

**DELETION OF EMERGENCY EXCEPTION PROVISIONS**

Mr. Hannaford explained that the ED had proposed deleting the emergency exception provisions from the Code as they pertain to bookkeeping and taxation services provided to audit clients that are public interest entities (PIEs). The majority of respondents had expressed support for this proposal for a number of reasons, including:

- The subjectivity of the terms "unusual" and "emergency;"
- The view that there are no situations that would warrant emergency exceptions;
- Concern over misuse of the provisions; and
- The view that such deletion would strengthen the Code.

A number of respondents had opposed the deletion of these provisions on grounds that include:

- The protection of client confidentiality;
- Time constraints;
- Potential difficulties in the client finding an alternative service provider, e.g., if the client or an affiliate is in a remote location; and
- A lack of resources for a smaller PIE.

Mr. Hannaford noted that a number of respondents had highlighted challenges specific to smaller PIEs and had requested that the provisions remain in the Code along with additional guidance concerning the emergency exception provisions. In view of these comments, he noted the Task Force's conclusion that the emergency exception provisions may be subject to misapplication in practice.

Given the extent of support of the proposed deletion of these provisions and the fact that respondents raised no convincing arguments, Mr. Hannaford noted the Task Force's conclusion that the ED proposal should remain unchanged. He highlighted that at its October 2015 meeting, the Board had supported the Task Force's conclusion.

The CAG supported the conclusion of the Task Force.

## MANAGEMENT RESPONSIBILITIES

### *Deletion of the term “significant”*

Mr. Hannaford noted that the term “significant” was deleted from paragraph 290.162 in the ED. The term qualified the responsibility of management in relation to decisions regarding the acquisition, deployment and control of human, financial, technological, physical, technological and intangible resources. He highlighted that 37 respondents had supported the deletion of the term “significant,” mainly because all decisions as noted in the paragraph are the responsibility of management, and that doing so would eliminate the subjectivity involved.

He noted that some respondents were opposed to the deletion as they felt that not all decisions concerning the acquisition, deployment and control of human, financial, technological and intangible resources are the responsibility of management. Some of these respondents had also argued that removing the term might have the unintended consequence of prohibiting the auditor from using professional judgment.

Mr. Hannaford noted that the Task Force continued to support the removal of the term “significant” from paragraph 290.162 because all decisions made on behalf of the client are management responsibilities regardless of the significance. He added that at its October 2014 meeting, the Board was in agreement with the Task Force’s conclusion.

Ms. Elliott inquired as to how the Task Force responded to the comment by UK National Audit Office regarding the proposed edit to the provisions of the Code concerning temporary staff assignments. The comment suggested that the removal of the term “significant” from paragraph 290.162 may limit the circumstances in which loaned staff assignments would be permitted under paragraph 290.140 of the Code. Mr. Hannaford noted that decisions concerning the acquisition, deployment and control of human, financial, technological, physical, technological and intangible resources as noted in paragraph 290.162 must be made by the client. Thus, loaned staff from a firm should not be in a position to make those decisions.

The CAG supported the conclusions of the Task Force.

### *Examples of Management Responsibilities*

Mr. Hannaford noted that the ED had proposed the following changes:

- Deletion of the first sentence of paragraph 290.163;
- Removal of the term “generally” in the lead-in sentence; and
- Refinements to the examples to make them more specific.

He noted that 40 respondents had agreed with the appropriateness of the proposed changes. Points of concern expressed by some respondents included the following:

- Deletion of the term “generally” from the lead-in sentence would remove the exercise of professional judgment;
- Inclusion of additional examples created a perception of an exhaustive list; and
- Confusion regarding the meaning of the term “supervising” which was included in two bullets within the examples.

Mr. Hannaford noted that the Task Force continued to support the removal of the term “generally” from the lead-in sentence. The Board accepted this point. The Task Force did propose to reinstate the first sentence of paragraph 290.163, as this sentence noted the use of professional judgment in determining whether an activity is a management responsibility. The Task Force also concluded that the term “supervising” could be interpreted in many different ways and, accordingly, it proposed to delete the term from the third and fifth bullets. At its October 2014 meeting, the Board had agreed with these conclusions.

The following matters were raised:

- Commenting via email, Ms. de Beer expressed support for the edits but was not opposed to the inclusion of the fifth bullet in paragraph 290.163, i.e., “Supervising activities for the purpose of management oversight” (which the Task Force had proposed to delete in light of the exposure draft responses).
- Mr. Hansen noted that professional accountants struggle with bookkeeping services and inquired as to why there is not an example noting maintaining books and records as a management responsibility. Mr. Hannaford noted that this list includes examples and is not intended to be exhaustive. Also, paragraphs 290.167 to 290.173 deal specifically with bookkeeping.
- Mr. Hansen further questioned why the last bullet in paragraph 290.163 (referring to designing, implementing or maintaining internal controls) should not also include “monitoring” as this is one of the elements of internal control under the COSO framework. Mr. Hannaford noted that the topic of monitoring internal controls is dealt with separately in the Code under the provisions addressing internal audit services. He further noted that the Task Force would consider the inclusion of the term “monitoring” within the bullet.
- Mr. Koltvedgaard confirmed that bookkeeping is not listed as an example of a management responsibility because it is addressed later in the Code. Mr. Hannaford agreed, noting that the specific guidance as to permitted bookkeeping services for non-PIEs is addressed in paragraphs 290.167 through 290.173. Mr. Hannaford further noted that inclusion of such an example may cause confusion. Mr. Hansen disagreed stating that it is even more confusing that the example is not included. Mr. Hannaford indicated that the Task Force would examine the possibility of including such an example.
- Mr. Fukushima expressed appreciation that the term “monitoring” would be reconsidered by the Task Force. He further questioned the basis for the proposed deletion of the term “supervising” from the list of examples. He felt that it would be appropriate to include this term in the list of management responsibilities, as day to day supervising involves judgment as it pertains to the operations of the client. Such activities may create threats to independence and undermine the objectivity of the auditor. Mr. Hannaford replied noting that there are some situations where supervising is a management responsibility and there may be other situations where it may not be as such. There are a plethora of examples to illustrate what may constitute the activity of “supervising.” However, the list of examples needed to be definite examples of management responsibilities since the term “generally” was removed from the lead in sentence.
- Mr. Greene expressed support for Mr. Hansen’s comments, noting that the examples should include bookkeeping and the preparation of financial statements, and that the term “monitoring” should also be included in the last bullet.

- Mr. Dalkin expressed support for Mr. Hansen's comments concerning "client books and records" on the grounds that basic concepts should be represented in the Code. Mr. Hannaford noted the risk of including too many examples in that it could be interpreted to be an all-inclusive list.

Mr. Kottvedgaard invited each Representative's views on the following matters:

- The deletion of the term "supervising" from bullets 3 and 5 in paragraph 290.163;
- Whether the term "bookkeeping" should be used in the examples of management responsibilities; and
- Whether the term "monitoring" should be referenced in the last bullet concerning internal controls.

Representatives commented as follows:

- Ms. Elliott agreed with the deletion of "supervision", adding "bookkeeping" as an example, and adding "monitoring" to the last bullet.
- Mr. Michel noted that the basic responsibility of the accountant or the person in control is the ownership of the records.
- Ms. Miller agreed with the deletion of the term "supervising," addition of an example noting "bookkeeping," and that the last bullet is acceptable without the term "monitoring."
- Ms. Robert expressed support for the removal of the term "generally" and the reinstatement of the first sentence to the paragraph. She further agreed with the inclusion of an example noting "bookkeeping" services but also agreed that some other examples be deleted, lest the list be seen as exhaustive.
- Mr. Thompson agreed with the inclusion of examples noting "bookkeeping" services and the inclusion of "monitoring" of controls in the last bullet and adding a cross reference to the appropriate guidance in the Code for both bullets.
- Mr. Waldron agreed with Mr. Thompson and supported the removal of the term "generally."

Mr. Kwok clarified that the examples noted in 290.163 are examples of definite management responsibilities. Guidance in the Code does permit some bookkeeping services under certain circumstances.

Mr. Hansen clarified that the examples should include management's responsibility to maintain the books and records of the entity. The intent of his comment was not to include a bullet that merely stated "bookkeeping." Mr. Hannaford noted that the Task Force would consider these points further.

#### *Prerequisites of Paragraph 290.165*

Mr. Hannaford noted that the prerequisites included in paragraph 290.165 were added to ensure that management makes appropriate decisions and takes proper responsibility for NAS performed by the auditor. He highlighted that 38 respondents had expressed support for the prerequisite, mainly because it supported the overall objective of the firm not assuming a management responsibility, thus enhancing independence and mitigating the self-review threat.

He explained that some respondents were opposed to the prerequisites on various grounds, including the following:

- The challenge of finding an individual at the client with suitable skill, knowledge and experience to oversee the service.
- The fact that the professional accountant must take action to ensure that the client is fulfilling the requirement.
- The challenges SME clients face.
- The possibility that a client may find these prerequisites unacceptable and thus engage a service provider not bound by the Code.

He explained that the Task Force continued to support the prerequisites as the majority of the respondents were supportive of the proposal. In addition, similar prerequisites had been put in place in some countries and by some of the larger firms. Further, the extant Code already required that management accept responsibility for all NAS. In order to meet such a requirement, the prerequisites would need to be met. The prerequisites were therefore effectively additional guidance in meeting such a responsibility.

Mr. Hannaford noted that some minor clarifications had been made to the paragraph since exposure. He added that the Board was in agreement with the Task Force's proposals.

The following matters were raised:

- Commenting via email, Ms. de Beer expressed strongly support for the proposed changes.
- Mr. Hansen expressed strong support for the paragraph. He further requested an explanation of the reasoning for not requiring documentation of the process. Mr. Hannaford noted that although documentation is not required, this does not mean that it is not necessary for considerations made by the auditor. Requiring documentation in the Code requires judgment and the Task Force did not believe documentation was essential.
- Mr. Hansen inquired if other terminology was considered for the paragraph such as "shall determine" or "shall conclude" as opposed to "shall be satisfied." Mr. Hansen suggested these two phrases may present stronger language. Mr. Hannaford noted the Task Force did not consider other language other than "shall be satisfied." The use of the word "shall" does create a requirement rather than present an option for the professional accountant. Mr. Hannaford further stated that the Task Force would consider the suggested phrases.

Representatives provided no other comments and supported the direction taken by the Task Force.

#### *Administrative Services*

Mr. Hannaford noted that the subject of administrative services still required further consideration by the Board. The ED had proposed moving the guidance pertaining to administrative services to a separate, stand-alone section within the Code since it was considered to be a separate NAS. He highlighted that that 43 respondents had supported this proposed change, with most of them noting greater clarity.

Some of the concerns expressed by respondents were focused on the potential confusion that may arise with the use of the phrase "routine or mechanical" in the two subsections (Administrative Services and Preparing Financial Statements and Accounting Records). Mr. Hannaford stated that the Task Force did not believe that the phrase "routine or mechanical" described a specific type of NAS, but rather a service that requires little or no professional judgment.

Mr. Hannaford noted that a regulatory respondent (the UK Financial Reporting Council) did not believe that administrative services should be performed for PIEs. To this point, Mr. Hannaford stated that the scope of the project was the clarification of certain sections of the Code. Thus, consideration of prohibiting certain services that are not currently prohibited by the Code was outside of the scope of this project.

Mr. Hannaford noted that another regulatory respondent (IOSCO) had expressed concern about some of the specific examples of administrative services included in the guidance. The ED had included an example of an administrative service of sending notices for clients. As that example was not included in the extant Code, the Task Force was proposing to delete it to avoid confusion.

Mr. Hannaford stated that the Task Force proposed to include a sentence at the end of the paragraph stating that the firm must be satisfied that the prerequisites in paragraph 290.165 were met when performing administrative services for an audit client. Some Board members had suggested that the performance of administrative services should not be subject to the informed management requirements of the extant Code and the prerequisites of paragraph 290.165. He noted that the Task Force believed that administrative services are subject to the same requirements of any other NAS. He added that this would be discussed further at the January 2015 IESBA meeting. He further noted that a reference to the guidance of paragraph 290.165 was also included in paragraph 290.171. Finally, he confirmed the support of the Board for the guidance on administrative services to be relocated into a separate section along with the examples included in the guidance.

The following matters were raised:

- Commenting via email, Ms. de Beer agreed with the conclusions of the Task Force.
- Mr. Koktvedgaard requested a tour de table to obtain views on the matter. The following Representatives also agreed with the Task Force's conclusions: Mss. Elliott, Miller and Robert, and Messrs. Dalkin, Greene, Hansen, Michel, Mr. Thompson and Waldron.
- Mr. Fukushima believed that the relocation of the guidance was a clarifying edit. However, he believed that the scope of the services that may be performed has expanded due to the statement that "Providing such services does not generally create a threat to independence." He further inquired if this expansion of permitted services would be outside of the scope of this project, given that paragraph 47 of Agenda Item B noted that prohibiting certain NAS not currently prohibited by the extant Code would be beyond the scope of this project. Mr. Fukushima also noted that some of the services within the guidance, such as monitoring statutory filing dates, could create threats to independence, thus contradicting the sentence stating that threats generally are not created. Finally, he noted concern with the phrase "little to no professional judgment," as this phrase is subjective. He requested additional guidance by the Board for clarification.
- Mr. Greene further commented that the sentence stating that administrative services generally do not create a threat to independence may be misleading. The guidance states that administrative services are a NAS. Thus, threats may be created. Ms. Robert agreed.

Mr. Hannaford noted that the Task Force was careful in ensuring that the examples included in the guidance were consistent with those in the extant Code. For example, the monitoring of statutory filing dates is already included in the Code. He noted that the paragraph further states that if there is a threat, it must be eliminated or reduced to an acceptable level, which is consistent with the general framework. He noted, however, that the Task Force would consider the sentence.



#### ROUTINE OR MECHANICAL

Mr. Hannaford noted that clarifications had been proposed in the ED to better explain what is meant by the phrase “routine or mechanical” as noted in paragraph 290.171. He highlighted that 46 respondents had expressed support for the proposed changes. The Task Force had made further refinements to the ED based on editorial suggestions from respondents. Mr. Hannaford noted that the Board had supported these proposed refinements.

The following matters were raised:

- Mr. Koktvedgaard invited tour de table views on the proposed changes. The following CAG Representatives expressed support for the edits made: Mss. Elliott and Miller, and Messrs. Dalkin, Greene, Hansen, Michel, and Waldron.
- Mr. Fukushima disagreed with the proposed changes. Specifically, he felt that the preparation of the financial statements would include the use of judgment and thus should not be included as an example of a service that is routine or mechanical. He also noted that IFRS for SMEs requires significant judgment in determining the classification and presentation of the financial statements. Accordingly, he felt that “preparation of the financial statements” should not be of a routine or mechanical nature.
- Mr. Hansen also agreed that the preparation of financial statements is not routine or mechanical. He suggested consideration of modifying the example.

#### EFFECTIVE DATE

Mr. Hannaford noted that the ED had proposed an effective date of not less than 12 months after the issuance of the final pronouncement. Twenty two respondents had expressed support for this proposal. Some respondents were of the view that the adoption of changes should be combined with changes arising from other projects.

The Task Force noted that the Long Association project was currently in the exposure process and the proposed effective date would be December 2017. The restructured Code under the other current project to restructure the Code would not be effective before December 2017. The Task Force was concerned over a potential two-year gap between the approval of the changes concerning NAS and the effective date of those changes. Accordingly, the Task Force proposed to maintain the original ED proposal, subject to Board concurrence.

Mr. Kwok noted that the Task Force did consider examining a list of non-audit services prohibited under the new EU audit regulation as well as the safeguards within the Code. He felt that many of the NAS pertaining to PIEs that are prohibited by the Code, provided that they are not material, would be consistent with the list of prohibited services under the EU audit legislation. He added that the Board would be more proactive in comparing the provisions of the Code with those of G20 jurisdictions.

Mr. Koktvedgaard invited tour de table views on the following:

- The proposed effective date.
- Whether the proposed changes to the Code are in the public interest
- Comments on the report-back on the March 2014 CAG discussion on the topic.

Mss. Elliott, Miller and Robert, and Messrs. Dalkin, Fukushima, Greene, Hansen and Michel agreed with the effective date. Representatives had no further comments.

Mr. Hannaford thanked the Representatives for their comments, noting that the Task Force would take into account the input in preparing the agenda material for the January 2015 IESBA meeting.

**C. PIOB Observer's Remarks**

Mr. Bhavé had no comments.

**D. Closing Remarks**

Mr. Kjørtvedgaard thanked the Representatives for their high level of participation and contributions, noting that the CAG was supportive of the Board proceeding to finalize the pronouncement, subject to its consideration of the CAG input. He then closed the meeting.