

NAS – Proposed Conforming Amendments to Section 400

(Mark-up from Extant¹)

This document includes notes to explain the rationale for the significant revisions being proposed by the Task Force.

INTERNATIONAL INDEPENDENCE STANDARDS

PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

SECTION 400

(...)

General

R400.11 A firm performing an audit engagement shall be independent.

R400.12 A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an audit engagement.

Prohibition on Assuming Management Responsibilities

~~600.7~~ **R400.13** A firm or a network firm shall not assume a management responsibility for an audit client.

~~600.7 A1~~ **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.

~~600.7 A2~~ **400.13 A2** Providing a ~~non-assurance~~professional service to an audit client creates self-review and self-interest threats if the firm or network firm assumes a management responsibility when performing the service. Assuming a management responsibility also creates a familiarity threat and might create an advocacy threat because the firm or network firm becomes too closely aligned with the views and interests of management.

~~600.7 A3~~ **400.13 A3** Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgment. Examples of activities that would be considered a management responsibility include:

- Setting policies and strategic direction.
- Hiring or dismissing employees.
- Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
- Authorizing transactions.
- Controlling or managing bank accounts or investments.
- Deciding which recommendations of the firm or network firm or other third parties to implement.
- Reporting to those charged with governance on behalf of management.

¹ The extant Code is the 2018 versions of the Code which is revised and restructured. It will come into effect in June 2019.

- Taking responsibility for:
 - The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
 - Designing, implementing, monitoring or maintaining internal control.

Providing Advice and Recommendations to Assist Management

~~600.7-A4~~ 400.14 A1 Provided that the firm or network firm is satisfied that client management makes all judgments and decisions that are the responsibility of management, firms and network firms might ~~provide~~ Providing the provisions of advice and recommendations to assist the management of an audit client in discharging its responsibilities is not assuming a management responsibility. For example, a firm or network firm might provide advice and recommendations when providing a non-assurance service to an audit client. In such circumstances, the requirements in Section 600 apply. (Ref: Para. R600.7 to 600.7 A3).

~~R600.8~~ R400.15 To be satisfied that client management makes all judgments and decisions that are the responsibility of management, when providing advice and recommendation to the management, the firm or network firm shall ensure that the audit client's management ~~To avoid assuming a management responsibility when providing any non-assurance service to an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the proper responsibility of management. This includes ensuring that the client's management:~~

- (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 services. While, the individual is not required to possess the expertise to perform or re-perform the service, the ~~Such an~~ individual, preferably within senior management, would need to understand:
 - (i) The objectives, nature and results of the services; and
 - (ii) The respective client and firm or network firm responsibilities.

~~However, the individual is not required to possess the expertise to perform or re-perform the services.~~ [Subsumed in the lead in paragraph above]
- (b) Provides oversight of the services and evaluates the adequacy of the results of the service performed for the client's purpose.
- (c) Accepts full ownership and responsibility for outcome of the service and the actions, if any, to be taken arising from the results of the services.

Consideration for Certain Related Entities

~~R600.10~~ R400.16 This section includes requirements that prohibit firms and network firms from assuming management responsibilities ~~or providing certain non-assurance services to for~~ audit clients. ~~As an exception to those requirements,~~ a firm or network firm may assume management responsibilities ~~or provide certain non-assurance services that would otherwise be prohibited when providing professional services~~ to the following related entities of the client on whose financial statements the firm will express an opinion:

- (a) An entity that has direct or indirect control over the client;
- (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; or

- (c) An entity which is under common control with the client,
provided that all of the following conditions are met:
- (i) The firm or a network firm does not express an opinion on the financial statements of the related entity;
 - (ii) The firm or a network firm does not assume a management responsibility, directly or indirectly, for the entity on whose financial statements the firm will express an opinion; and
 - ~~(iii) The services do not create a self-review threat because the results of the services will not be subject to audit procedures; and~~
 - ~~(iiiiv)~~ (iv) The firm addresses other threats created by providing such services that are not at an acceptable level.

[Paragraphs 400.173 to 400.19 are intentionally left blank]

1. *Repositioning of Prohibition, Exemption and Other Provisions Relating to Assuming Management Responsibility*
- At its March 2019 meeting, the Board generally agreed to the Task Force’s proposal to move the general prohibition and supporting provisions relating to assuming management responsibilities to Section 400.
 - The new placement puts the prohibition in closer proximity to the requirement for the firm to be independent.
 - This proposal is responsive to views from regulators and the PIOB who have questioned clarity of those provisions and emphasizes that assuming management responsibilities is prohibiting when providing all professional services to audit clients, not only for NAS engagements.
 - With respect to the proposed revisions in R4600.16, the words “To avoid assuming a management responsibility when providing any non-assurance service to an audit client, the firm shall ...” are replaced with wording that was suggested by regulatory respondents to the Safeguards Phase 2 Exposure Draft.

Related Entities

R400.20 As defined, 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.

[Paragraphs 400.21 to 400.29 are intentionally left blank]

Period During which Independence is Required

All Audit Clients

R400.30 Independence, as required by this Part, shall be maintained during both:

- (a) The engagement period; and
- (b) The period covered by the financial statements.

- 400.30 A1 The engagement period starts when the audit team begins to perform the audit. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final audit report.
- R400.31** If an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion, the firm shall determine whether any threats to independence are created by:
- (a) Financial or business relationships with the audit client during or after the period covered by the financial statements but before accepting the audit engagement; or
 - (b) Previous services provided to the audit client by the firm or a network firm.
- 400.31 A1 Threats to independence are created if a non-assurance service was provided to an audit client during, or after the period covered by the financial statements, but before the audit team begins to perform the audit, and the service would not be permitted during the engagement period.
- 400.31 A2 Examples of actions that might be safeguards to address such threats include:
- Using professionals who are not audit team members to perform the service.
 - Having an appropriate reviewer review the audit and non-assurance work as appropriate.
 - Engaging another firm outside of the network to evaluate the results of the non-assurance service or having another firm outside of the network re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

Audit Clients that are Public Interest Entities

- R400.32** The firm or network firm shall not accept appointment as auditor of a public interest entity to which it has provided a non-assurance service that would not be permitted during an engagement period unless the provision of such service has ceased and:
- (a) The result of the service has been subject to audit by a firm outside of the network,
or
 - (b) Another firm outside of the network reperforms the service to the extent necessary to enable that firm to take responsibility of the service.

[Paragraphs 400.3~~32~~ to 400.39 are intentionally left blank]

(...)

2. *Enhanced Clarity Period During which Independence is Required (i.e., Cleansing Provision)*
- With respect to audits of public interest entities, the Task Force is proposing a requirement to clarify the conditions under which a firm or network firm can accept an engagement to be an independent auditor for an entity where that firm or network firm previously provided a prohibited NAS to the entity.