Proposed Revisions to the Non-Assurance Services Provisions of the Code

Dear Sirs:
Assirevi is the association of the Italian audit firms. Its member firms represent the vast majority of the audit firms licensed to audit companies listed on the Italian stock exchange and other public interest entities in Italy, under the supervision of CONSOB (Commissione Nazionale per le Società e la Borsa).

Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for the benefit of its members. It collaborates with CONSOB, the Italian accounting profession and other bodies in developing auditing and accounting standards.

Assirevi is pleased to submit its comments on the Exposure Draft “Proposed Revisions to the Non-Assurance Services Provisions of the Code” issued by IESBA on January 2020, as detailed in the enclosed document.

Should you have any queries, please do not hesitate to contact us.

Yours faithfully,

Gianmario Crescentino
Chairman of Assirevi

(Enclosure)
COMMENTS ON THE IESBA EXPOSURE DRAFT

Proposed Revisions to the Code Provisions on Non-Assurance Services

(January 2020)

Assirevi is grateful for the opportunity provided with the above-mentioned Consultation Paper and is pleased to contribute by providing its comments on the project described therein.

Firstly, our Association agrees on the purpose of ensuring “that all the NAS provisions in the IIS are robust and of high quality for global application, thereby increasing confidence in the independence of audit firms”.

However, although we agree on the above purpose, we deem it appropriate to draw IESBA’s attention to an overarching comment, which is further developed in our responses to the specific questions below.

Indeed, we deem it necessary to recall that the Code of Ethics was created with a principle based approach and has substantially been relying on this approach until today. This has rendered the Code a highly useful document aimed at steering auditors’ behaviors also in different (and not always consistent) national legal frameworks.

Instead, the most recent projects on the revision of the Code of Ethics seem to be trending progressively away from the original principle based approach, and turning to more of a rule based approach, which would better match enforcement purposes. However, in Assirevi’s view, this change may partially distort the inherent purpose of the Code and trigger two adverse consequences for the system:

(i) the overlap between the Code and the national laws on independence in force in individual Countries which apply the Code, which would inevitably raise several coordination issues;

(ii) the disappearance from within the Code of both conduct principles and relevant case examples, which do allow to steer auditors’ behavior in different situations but cannot be pursued through a rule based approach.

Given the above, in Assirevi’s view certain amendments that have been proposed in the context of this project seem to be in line with the above-mentioned undesirable consequences, and do raise the risk of jeopardizing the guidance and steering function of the Code in relation to a fundamental aspect of auditor’s independence: the provision of non-audit services.

Moreover, as clarified in our responses no. 1, 4, 5 e 6, if IESBA were to confirm the orientation to implement a set of rules rather than a set of principles, a possible mismatch between the rules set forth by national an supranational legal systems (such as the Italian and European legal systems), on the one side, and the rules of the Code, on the other side, might occur.

In the same perspective of making the Code of Ethics a useful guidance to steer auditors’ behavior, according to Assirevi, it is of the utmost importance that the provisions of the Code are set out as clearly as possible and are not generic. Accordingly, as clarified in our responses no. 1 and 2 below, we suggest to outline with adequate precision (i) the self-review threat, (ii) which services might create such threat and (iii) what timeframe is to be considered in such evaluation.

In light of the above, please find below some comments relating to specific questions contained within the explanatory memorandum to the Exposure Draft.
1. **Do you support the proposal to establish a self-review threat prohibition in proposed paragraph R600.14?**

The current IESBA framework relating to self-review is based on the principle, shared by Assirevi, that the provision of a non-audit service (hereinafter “non-audit service” or “NAS”) to an audit client compromises the auditor’s independence if it creates a self-review threat that cannot be reduced to an acceptable range, thereby making that NAS not allowed.

With particular regard to Public Interest Entities (hereafter “PIEs”), the wording proposed by IESBA in this project with reference to the self-review threat introduces a significant change of approach in assessing the admissibility of a service. In Assirevi’s view, this change is neither acceptable nor sufficiently clear.

The introduction made by IESBA of paragraph R600.14 entails the effect to preclude any assessment on the materiality of the self-review threat, effectively denying the relevance or applicability of possible safeguards in respect of any identified threats. The mere existence of a self-review threat therefore becomes crucial in the assessment process, removing any relevance of the materiality of the threat itself.

In this regard, Assirevi recalls that several regulators (such as the SEC and the European Union Parliament) have introduced restrictions to the provision by the auditor of certain categories of services to audited PIEs, thus identifying for those services, and only for them, the existence of a threat to independence that no safeguards are deemed sufficient to appropriately reduce, and therefore cannot be assessed through principles of materiality. The introduction of this provision by the IESBA would therefore require, as a minimum, a careful consideration of the coordination with provisions already existing in different legal systems, in order to avoid overlaps or conflicts that could create issues in the application of the various rules as a whole.

From a different standpoint, Assirevi notes that disregarding the evaluation of materiality in assessing the possible threat to independence underlying the performance of any type of NAS does not appear fully in line with the Code's current principle-based approach. As it is well known, materiality characterizes the current conceptual framework of the Code, as this concept must necessarily be considered in the execution of the “reasonable and informed third party test” in order to assess the relevance of any independence threats.

2. **Does the proposed application material in 600.11 A2 set out clearly the thought process to be undertaken when considering whether the provision of NAS to an audit client will create a self review threat? If not, what other factors should be considered?**

Assirevi believes that the wording indicated in paragraph 600.11 A2 is not clear enough and does raise significant doubts as to its interpretation.

Firstly, the provisions set out in paragraph 600.11 A2 are not consistent with the provisions under paragraph 600.9 A2, which does not appear to have been either amended or coordinated by the IESBA. In fact, this latter paragraph currently outlines the relevant factors aimed at identifying the possible independence threats created by the provision of NAS to audit clients. In Assirevi’s view, some of the factors identified therein (ref. sub-paragraphs 7-9) appear to be attributable to the self-review threat.
Therefore, in our view, there is a mismatch between the provisions contained in the two above-mentioned paragraphs, in particular with regard to the factors to be considered in assessing whether or not a self-review threat exists. Assirevi believes that this mismatch may create a misunderstanding on the content of the two paragraphs. A useful clarification could be introduced in order to specify that paragraph 600.9 A2 does not lay down an exhaustive list and additional factors might exist.

In Assirevi’s view, the proposed formulation of letters (a), (b) and (c) of paragraph 600.11 A2 may lead to further interpretative doubts. In fact, the relation among those provisions is not fully understandable. In particular, it is not clear whether the three conditions should jointly or alternately occur to cause a self-review threat. Assirevi believes that such conditions should jointly occur.

Furthermore, with specific reference to paragraph 600.11 A2, it is worth noting that the first situation which can create a self-review threat, reported in letter (a), is too generically described: “the results of the service will affect the accounting records, internal controls over financial reporting, or the financial statements on which the firm will express an opinion”. Assirevi believes that there is a real risk that many of the services provided by the auditor may ultimately turn out to be considered as included in the above definition. This does not seem to reasonably represent the genuine intention of the IESBA in formulating the proposed amendments to the Code.

Therefore, Assirevi takes the view that clarifications to the application of the above-mentioned provisions should be introduced – taking also into account that, in the context of the services provided by the auditor to PIEs, the provisions concerning the assessment of materiality with respect to the audited financial statements has been removed, as well as the chance to adopt safeguards in case of a self-review threat.

From a further standpoint, in the view of Assirevi it is essential that the principle of materiality is applied in the self-review threat assessment process consistently with the provisions of the international standards on auditing. For instance, in relation to the specific point of materiality, ISA 330 - among others - stating that “The extent of an audit procedure judged necessary is determined after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain”, should be considered.

3. Is the proposed application material relating to providing advice and recommendations in proposed paragraph 600.12 A1, including with respect to tax advisory and tax planning in proposed paragraph 604.12 A2, sufficiently clear and appropriate, or is additional application material needed?

Assirevi believes that paragraph 600.12 A1 needs further guidelines in order to clarify certain aspects and allow for a better understanding, by the users of the Code, of the improvements that have been introduced therein.

In particular, further guidelines are necessary in order to specify that:

i) not all the services that include “advice and recommendations” entail the creation of a self-review threat and, accordingly,

ii) not all such services shall automatically be included in the prohibited NAS for PIEs under rule R600.14.
In Assirevi’s view these additional guidelines could focus on the identification of the elements to be used, in the circumstances, to assess whether a self-review threat does in fact occur (e.g. detailed aspects of the “nature of the advice and recommendations”, as well as clarifications on the skills that are expected from the client’s staff for them to be able to autonomously implement the subject of “advice and recommendations”.

Moreover, Assirevi deems it useful that an express specification is introduced in the Code on the following aspects: i) what is reported in paragraph 600.12 A1 represents a “base line” and ii) what is specifically described in the following sections dedicated to individual non-audit services must prevail over the “base line”.

In respect of the subsections relating to specific non-audit services, Assirevi highlights the following issues:

1. Paragraph 601.2 A3 includes “providing technical advice” among the accounting and bookkeeping services. In Assirevi’s view, this example should be deleted because the provision of advice cannot be considered as an accounting and bookkeeping service;

2. Paragraph 604.12 A2 on “tax advisory and tax planning” services uses the expression “likely to prevail”. In this regard, Assirevi notes that this term, used to express a concept of likelihood, does not result commonly recognized or used in the context of professional standards and, accordingly, could generate interpretation issues. Therefore, it is suggested to use the wording “more likely than not” that is already commonly used in the accounting standards.

4. Having regard to the material in section I, D, “Project on Definitions of Listed Entity and PIE” and the planned scope and approach set out in the approved project proposal, please share your views about what you believe the IESBA should consider in undertaking its project to review the definition of a PIE”.

Assirevi agrees with the need to review the definition of PIEs, which is crucial to determine who falls within the scope of certain provisions of the Code, and in particular within the provisions relating to NAS and Fees.

In this regard, Assirevi suggests to take into account firstly the fact that in several national and supranational systems a definition of PIEs has already been provided and that belonging to this category implies the respect of profiles that are not exclusively related to auditor’s independence.

Therefore, in order to avoid a potential mismatch between what is imposed at a local regulatory level and what is defined by the Code (with consequent difficulties and uncertainties of application), it would be appropriate for the IESBA to clarify that the definition provided by the Code is only applicable in the absence of a definition of PIEs already provided at a national level under local law. This approach is not inconsistent with the current Code framework, which defines a PIE as a “listed entity” or an entity defined as such “by regulation or legislation”.

In fact, the definition of PIEs relates to an important element of public interest on which national or supranational Legislators have an informed background and adequate competence. Therefore, in order to fully protect the public interest, the IESBA should only intervene where no provisions have been set out by local Legislators.
In any case, with regard to the listed entities to be included in the definition of a PIE, Assirevi believes that the Code should not refer to “recognized stock exchange” and “marketed under the regulations of a recognized stock exchange or other equivalent body” but to the notion of “regulated markets”, as required by EU legislation.

In fact, the entities admitted to recognized stock exchanges are normally subject to a different and less stringent set of rules than those applicable to companies admitted to regulated stock exchanges. This choice, which is generally made by all Legislators, is aimed at encouraging the listing on these markets by making relevant requirements less burdensome and relevant rules less complex. Accordingly, we deem it not appropriate to consider at the same level, in the context of the Code, entities listed on “recognized stock exchanges” and entities whose securities are traded on “regulated stock exchanges”, since the significant differences in the rules governing those different types of markets would not be taken into due consideration.

5. Do you support the IESBA's proposals relating to materiality, including the proposal to withdraw the materiality qualifier in relation to certain NAS prohibitions for audit clients that are PIEs (see Section III, B “Materiality”)?

In Assirevi’s view, the withdrawal of the concept of materiality does not seem to either improve and/or strengthen the Code as a whole, or represent an additional safeguard for auditor’s independence. Indeed, if an issue, or a transaction, or even an element, is immaterial, by its very nature, neither it has an impact on the self-review threat, nor on the audit or on auditor’s independence.

The change in approach proposed in this Exposure Draft appears to be generated by a theoretical perception of the “materiality” element in the context of independence, rather than by issues and situations actually observed in reality, where immaterial issues are indeed unable to have any impact on auditor’s independence.

In Assirevi’s view, therefore, this proposal does not respond to a real need arising from circumstances that have been observed in practice, but only to a perception and intent to progressively transform the approach underpinning the Code from a principle based to a rule based one. Assirevi does not support this approach because, in addition to distorting the philosophical principles on which the Code is based, it would make the adoption of the Code itself increasingly complex in the various jurisdictions that may have already adopted a solid regulatory framework for auditor’s independence.

One of the consequences that would reasonably arise from the withdrawal of the concept of materiality would be a likely increase in violations which, by their very nature - indeed being them immaterial - would not compromise auditor’s independence. Instead, this would sort the effect of contributing to undermining public reliance on audits because of the perception it would induce. In this way, such a change would play a negative role – precisely against the public interest.

In other words, the proposal is likely to lead to a result that runs contrary to what the Code aspires to achieve: reducing the perception that audit serves the public interest, instead of enhancing it.
6. Do you support the proposal to prohibit the following NAS for all audit clients, irrespective of materiality:

a) Tax planning and tax advisory services provided to an audit client when the effectiveness of the tax advice is dependent on a particular accounting treatment or presentation and the audit team has doubt about the appropriateness of that treatment or presentation (see proposed paragraph R604.13)?

b) Corporate finance services provided to an audit client when the effectiveness of such advice depends on a particular accounting treatment or presentation and the audit team has doubt about the appropriateness of that treatment or presentation (see proposed paragraph R610.6)?

With reference to “Corporate Finance” services, addressed in subsection 610, Assirevi believes that “Due Diligence in relation to potential acquisitions and disposals” services should be excluded from the examples of corporate finance services (paragraph 610.2 A1). In fact, although due diligence services are usually provided in connection with merger and acquisition activities, such services significantly differ, by their very nature, from the other types listed in the Code, to which the indications listed in the abovementioned subsection apply. Furthermore, the classification of due diligence as a corporate finance service would entail a high risk of confusion for the users of the Code due to the provisions of EU Regulation 537/2014. In fact, such Regulation, on the one hand, provides for a specific prohibition of corporate finance services (services referred to in letter (i), paragraph 1 art. 5) but, on the other hand, it includes, in recital no. 8, an explicit indication as to the permissibility of due diligence services.

In Assirevi’s view, therefore, the inclusion of due diligence in a category of services that are generally not eligible, also as a result of the provisions of EU Regulation 537/2014, could give rise to risks of confusion in assessing the compatibility of this type of service with the independence principles.