KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

Ken Siong
Senior Technical Director
International Ethics Standards Board for Accountants (IESBA)
529 Fifth Avenue, 6th Floor
New York, NY 10017
USA

Our ref SRA/288

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Dear Mr. Siong

Exposure Draft: Proposed Revisions to the Non-Assurance Services Provisions of the Code

We appreciate the opportunity to comment on the above Exposure Draft issued by the International Ethics Standards Board for Accountants (IESBA or the Board). We have consulted with, and this letter represents the views of, the KPMG network.

We agree on the importance of auditor independence and the Board's goal of high quality independence standards for global application that increase public confidence in the quality of audits of financial statements. While we agree with many of the proposals in this Exposure Draft, we have several key areas of concern that are highlighted below (see A-D). The appendix to this letter provides our responses to the specific questions posed in the Exposure Draft.

A. PIE definition project

As the term public interest entity (PIE) is defined in the extant Code, we agree with the Board's view that stakeholders of these entities have heightened expectations regarding the audit firm's independence and, similarly, we agree with the provision of independence standards specific to PIEs. However, with a project currently underway to revisit the definition of a PIE, it is uncertain whether the project will result in a revised definition that includes a broader array of entities.

Accordingly, our comments herein are based on, and should be considered by the Board solely in the context of, our understanding of PIEs as they would be determined under the extant Code.

We suggest the Board complete the PIE definition project before moving forward with approval and issuance of the non-assurance services (NAS) standard, so that stakeholders can consider the NAS proposals in the context of an expanded PIE

definition. We believe these are critical considerations given the nature and extent of the new independence requirements proposed for PIEs, most notably, the prohibition of NAS that result in the creation of a self-review threat in relation to the financial statements on which the audit firm will express an opinion.

B. Application guidance related to the identification of a self-review threat

We appreciate the Board's thoughtful drafting of the overarching prohibition of providing NAS to PIE audit clients when a self-review threat will be created, and we are supportive of such prohibition. We also believe the three criteria provided in points (a), (b), and (c) of 600.11 A2, as application guidance for identifying the creation of a self-review threat, are sufficiently clear. However, we believe the interpretation of the application of these three criteria may be diverse among users of the Code due to the use of the phrase "whether there is a risk that" in the lead-in paragraph to the three criteria. We are uncertain what this phrase intends, and absent other clarification, we have concerns about the varying interpretations that firms and other users of the Code may apply when trying to identify whether a self-review threat is created using the guidance in 600.11 A2 as a result of this phrase. We also have a concern that considering the "risk" that the three criteria will occur without any scaling for the probability of such occurrence could result in an interpretation that virtually all NAS provided to PIEs would be prohibited, which we understand not to be the intention of the Board. As such, we recommend removing the words "there is a risk that" from the application guidance in 600.11A2.

C. Grouping technical advice on accounting issues with accounting and bookkeeping services

Providing technical advice on accounting issues is cited in 601.3 A4 of the extant Code as a service that does not usually create threats, and accordingly, it is not listed as an example of an accounting and bookkeeping service subject to the requirements of this subsection. We have noted that a proposed change to extant Section 601 is to specifically identify technical advice on accounting issues as an example of an accounting and bookkeeping service, thereby subjecting NAS involving such advice to the proposed requirements and application guidance in this subsection. As a result, based on the application guidance in proposed 601.3 A1, providing such technical accounting advice as part of a NAS would be deemed to create a self-review threat solely when the results of the services will affect the accounting records or the financial statements on which the firm will express an opinion, without consideration to the other two criteria present in 600.11 A2. We believe this would likely result in the substantial prohibition of providing technical accounting advice through a NAS to PIE audit clients.

We suggest the removal of technical advice on accounting issues from the examples of accounting and bookkeeping services. We believe that the provision of such technical advice does not have a direct linkage to the preparation of the financial statements and the underlying accounting records as compared to the other examples of accounting and bookkeeping services noted in Section 601.

This is because of the extent of judgment required to be applied, and action required to be taken, by client management to evaluate and implement the technical advice as they determine appropriate, and then execute the financial accounting and reporting based on their judgment. We believe, therefore, that the three criteria included in 600.11 A2 should be allowed to be applied in determining whether the provision of technical advice on accounting issues creates a self-review threat, similar to how they are to be applied for other NAS through which advice and recommendations are provided as indicated in 600.12 A1. Being subject to just criteria (a) of 600.11 A2, as indicated by 601.3 A1, would likely result in an incorrect conclusion that a self-review threat is created. A substantial prohibition of providing technical advice to PIEs would not best serve the public interest in some cases as it is often the audit firm that is best positioned to provide such technical advice to its clients, thereby, enhancing the quality of financial reporting. Prohibiting use of the audit firm for these services may impact the quality of the advice provided or discourage management from pursuing technical advice on accounting issues at all, thereby creating a greater risk to the quality of the financial statements than the independence risk otherwise created.

Lastly, we believe that SEC regulations and current SEC statements related to technical accounting advice and the basis thereof should be considered, as further discussed in the Appendix.

D. Including due diligence services with corporate finance services

The inclusion of due diligence services within the definition of corporate finance services is inconsistent with both market practice and market understanding of corporate finance services, and has the potential to confuse those charged with governance (TCWG). We think there is significant merit in the approach elsewhere in the specific subsections to Section 600 of grouping services with similar independence characteristics together to assist TCWG in more readily understanding the threats to independence. However, the objective nature of traditional due diligence services generally does not create a self-review or advocacy threat, and is therefore not aligned with the profile of corporate finance services, introducing inconsistency in the approach. We recommend that due diligence services be excluded from the description of corporate finance services. Due diligence services are effectively covered by Advice and Recommendations in 600.12 A1 or in Valuations in subsection 603. We also believe the EU regulations should be considered related to the permissibility of due diligence services, as discussed in the Appendix.

Lastly, we prompt the Board to consider carefully the implementation period so that sufficient time is provided for firms to operationalize the new requirements of the approved standard. This will be crucial given the volume of significant new proposals from several projects that will likely become effective within a short span of time, if not simultaneously (e.g., NAS, Fees, Role and Mindset, and Definition of Listed Entity and PIE).

Please contact Karen Bjune at kbjune@kpmg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

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Appendix A: Responses to Specific Questions

1. ***Do you support the proposal to establish a self-review threat prohibition in proposed paragraph R600.14?***

   We are generally supportive of this proposal based on the premise that stakeholders have a heightened expectation of an audit firm's independence from public interest entity (PIE) audit clients. However, our support is grounded on the consideration of this prohibition through the lens of the current definition of a PIE. Given the potential change to the definition of a PIE, we cannot know whether we would agree with this heightened expectation unilaterally for a broader range of entities that may be considered to be PIEs as a result of the PIE definition project.

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 a NAS to an audit client will create a self-review threat? If not, what other factors should be considered?***

   We appreciate the Board's thoughtful drafting of the overarching prohibition of providing NAS to PIE audit clients when a self-review threat will be created, and we are supportive of such prohibition. We also believe the three criteria provided in points (a), (b) and (c) of 600.11 A2, as application guidance for identifying the creation of a self-review threat, are sufficiently clear. However, we believe the application of these three criteria may be unclear due to the use of the phrase "whether there is a risk that" in the lead-in paragraph to the three criteria. We are uncertain what this phrase intends, and absent other clarification, we have concerns about the varying interpretations that firms and other users of the Code may apply when trying to identify whether a self-review threat is created using the guidance in 600.11 A2 as a result of this phrase. We also have a concern that considering the "risk" that the three criteria will occur without any scaling for the probability of such occurrence could result in an interpretation that virtually all NAS provided to PIEs would be prohibited, which we understand not to be the intention of the Board. As such, we recommend removing the words "there is a risk that" from the application guidance in 600.11 A2.

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?***

   Given the need for regular discussions between auditors and client management, and to avoid an implication that such essential discussions are prohibited, negatively impacting audit quality, we suggest moving 601.2 A2 to follow 600.12 A1.

We believe 600.12 A1 should more clearly state the relationship between the general nature of this application material and any prohibitions or application material for specific services outlined in subsections 601-610. We suggest an edit to the opening of 600.12 A1 such as the following: "As noted at 600.3, specific guidance on non-assurance services is provided in subsections 601-610. When relevant application material is not specifically detailed in those subsections, determining whether providing advice and recommendations creates a self-review threat would involve making the determination set out in 600.11 A2. This includes considering…"

Related to 604.12 A2, the threshold of "likely to prevail" is not a recognized standard and will be subject to various interpretations. We believe the public interest would be best served here by the "rule of law" and thus, we recommend use of "more likely than not" as this is understood in practice and consistent with various standards and institutions such as the FASB ASC 740 standard, PCAOB requirements and the IRS penalty provisions. Given the first two criteria in 604.12 A2, we do not believe this change to "more likely than not" would weaken the overall application material in determining a permissible service.

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?***

When determining the entities that should be included in the term "PIE," the IESBA should consider the typical use of the financial statements by stakeholders. For instance for some entities, public interest stems from the services provided by the entities and historical financial statements may not be a key source of information for decision-making by stakeholders. Thus, a heightened expectation of the audit of the financial statements would not be warranted (e.g., for a not-for-profit or governmental entity). For these reasons, these types of entities should continue to be scoped out of the definition of a PIE.

The definition resulting from this project should be very clear, limiting opportunities for judgment. We also recommend that any definition of PIE continues to be a baseline standard to which the regulators or legislators in local jurisdictions can add further entities as deemed appropriate. Given the PIE regulation and legislation currently in place in many jurisdictions, we believe development of a definition that is intended to be inclusive of all potential types of PIEs creates the risk of conflict between these jurisdictional provisions and the Code, resulting in incremental complexity in the application of the Code and potential confusion among entities, auditors, and stakeholders.

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")?***

We view materiality of the impact of the NAS on the financial statements to be a relevant and important factor in identifying and evaluating threats to independence for "all audit clients," but do not take exception to the proposal to withdraw the materiality qualifier from prohibitions of specific NAS provided to PIE audit clients, particularly given the overarching prohibition on NAS provided to PIE audit clients that would create a self-review threat.

We noted that several sections of the Code applicable to "All Audit Clients" retain factors that are relevant in evaluating the level of self-review and advocacy threats. Given the overarching prohibition on providing NAS to PIE audit clients when a self-review threat is identified, the Code would be inconsistent to then list factors to evaluate the self-review threat for all audit clients. We recommend revising paragraphs 603.3 A2, 604.12 A3, 604.22 A1, 607.4 A1 and 610.4 A1 to delete "and evaluating the level of any such threats" and then add a second paragraph such as the following example related to 610.4 A1:

610.4 A2 "The factors relevant for identifying self-review or advocacy threats in 610.4 A1 are the same factors relevant in evaluating the level of any such threats created by providing corporate finance services to an audit client, except in the instance where a self-review threat has been identified for a PIE audit client. When a self-review threat for a PIE audit client has been identified, the service cannot be provided."

600.9 A2 also notes factors relevant in evaluating threats for all audit clients. Explanatory wording is needed to bridge the evaluation of threats for all audit clients to the prohibition that follows at R600.14, so it is clear that the prohibition does not allow an identified self-review threat to be evaluated for a PIE audit client.

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)?

We do not support the proposal to prohibit the NAS noted in (a) and (b) for non-PIE audit clients, irrespective of materiality. If the impact of that NAS is not expected to be material to the audited financial statements, the chance of a self-review threat being created is low. In addition, we believe it would be cost prohibitive for a non-PIE audit client to find an alternative service provider especially if the impact of that NAS is not expected to be material to the audited financial statements.

If due diligence remains as an example of corporate finance services in Section 610, we believe the requirement in item (b) should be made exclusive of due diligence services or should be revisited to consider the addition of due diligence services as we believe such requirement may be difficult in practice to apply to due diligence services as currently provided. See additional discussion of due diligence services at Q10.

7. *Do you support the proposals for improved firm communication with TCWG (see proposed paragraphs R600.18 to 600.19 A1), including the requirement to obtain concurrence from TCWG for the provision of a NAS to an audit client that is a PIE (see proposed paragraph R600.19)?*

We generally support the proposals for improved firm communication with TCWG. However, we believe such requirements should be limited to the PIE audit client and its consolidated controlled entities. Applying the proposed requirement to related entities that are not consolidated, but over which the audit client technically has direct or indirect control (e.g., a portfolio investee of a private equity house), would present challenges because:

- the audit client may not have decision-making authority and
- TCWG may not be capable of evaluating the permissibility of services provided to entities that are not consolidated in the PIE audit client's financial statements.

We also suggest expanding the application material under 600.19 A1 or providing non-authoritative guidance to include:

- acceptable methods of sharing information with TCWG, similar to that given for obtaining concurrence, and
- for PIEs other than listed entities, additional guidance on methods of obtaining approval of non-assurance services, given potentially less formal governing boards/committees.

We further suggest combining the requirements in R600.18 and R600.19 to one two-part requirement with the application material in 600.18 A1, 600.19 A1 and 600.19 A2 supporting that joint requirement paragraph.

8. ***Do you support the proposal to move the provisions relating to assuming management responsibility from Section 600 to Section 400, and from Section 950 to Section 900?***

   We generally support the movement of the provisions relating to assuming management responsibility described above.

9. ***Do you support the proposal to elevate the extant application material relating to the provision of multiple NAS to the same audit client to a requirement (see proposed paragraph R600.10)? Is the related application material in paragraph 600.10 A1 helpful to implement the new requirement?***

   We do not take exception to the proposed requirement on the provision of multiple NAS to the same audit client, nor do we have comments on the related application material.

10. ***Do you support the proposed revisions to subsections 601 to 610, including:***

    (a) The concluding paragraph relating to the provision of services that are "routine or mechanical" in proposed paragraph 601.4 A1?

    We support the examples of routine and mechanical accounting and bookkeeping services included under 601.4 A1.

    (b) The withdrawal of the exemption in extant paragraph R601.7 that permits firms and network firms to provide accounting and bookkeeping services for divisions and related entities of a PIE if certain conditions are met?

    We do not take exception to the removal of the exemption.

    (c) The prohibition on the provision of a tax service or recommending a tax transaction if the service or transaction relates to marketing, planning or opining in favor of a tax treatment, and a significant purpose of the tax treatment or transaction is tax avoidance (see proposed paragraph R604.4)?

    We do not take exception to the prohibition of the type of tax service described above. As indicated in our response to Q3, we do believe the threshold of "likely to prevail" is not a recognized standard and will be subject to various interpretations.

However, we believe it is clearly a higher threshold than a "more likely than not" standard, which we believe is appropriate for this type of tax service.

(d) The new provisions relating to acting as a witness in subsection 607, including the new prohibition relating to acting as an expert witness in proposed paragraph R607.6?

Additional clarification would be beneficial for the application of the new prohibition relating to acting as an expert witness, given a likelihood of various interpretations by stakeholders, including that of a regulator.

Additional subsection 601-610 comments:

— Subsection 601

Providing technical advice on accounting issues is cited in 601.3 A4 of the extant Code as a service that does not usually create threats, and accordingly, it is not listed as an example of an accounting and bookkeeping service subject to the requirements of this subsection. We have noted that a proposed change to extant Section 601 is to specifically identify technical advice on accounting issues as an example of an accounting and bookkeeping service, thereby subjecting NAS involving such advice to the proposed requirements and application guidance in this subsection. As a result, based on the application guidance in proposed 601.3 A1, providing such technical accounting advice as part of a NAS would be deemed to create a self-review threat solely when the results of the services will affect the accounting records or the financial statements on which the firm will express an opinion, without consideration to the other two criteria present in 600.11 A2. We believe this likely would result in the substantial prohibition of providing technical accounting advice through a NAS to PIE audit clients.

We suggest the removal of technical advice on accounting issues from the examples of accounting and bookkeeping services. We believe that the provision of such technical advice does not have a direct linkage to the preparation of the financial statements and the underlying accounting records as compared to the other examples of accounting and bookkeeping services noted in Section 601. This is because of the extent of judgment required to be applied, and action required to be taken, by client management to evaluate and implement the technical advice as they determine appropriate, and then execute the financial accounting and reporting based on their judgment. We believe, therefore, that the three criteria included in 600.11 A2 should be allowed to be applied in determining whether the provision of technical advice on accounting issues creates a self-review threat, similar to how they are to be applied for other NAS through which advice and recommendations are provided

as indicated in 600.12 A1. Being subject to just criteria (a) of 600.11 A2, as indicated by 601.3 A1, would likely result in an incorrect conclusion that a self-review threat is created. A substantial prohibition of providing technical advice to PIEs would not best serve the public interest in some cases as it is often the audit firm that is best positioned to provide such technical advice to its clients, thereby enhancing the quality of financial reporting. Prohibiting use of the audit firm for these services may impact the quality of the advice provided or discourage management from pursuing technical advice on accounting issues at all, thereby creating a greater risk to the quality of the financial statements than the independence risk otherwise created.

Lastly, we believe that the SEC regulations and the current SEC statements related to technical accounting advice and the basis thereof should be considered. 17 CFR Section 210.2-01(c)(4)(1) does not include technical accounting advice among examples of "Bookkeeping or other services related to the accounting records or financial statements of the audit client." Further, in a speech by SEC staff before the 2007 AICPA National Conference on Current SEC and PCAOB Developments, the following was stated on the topic of Accounting Application Assistance:

> *"Management is responsible for the financial statements, and responsibility for the choices and judgments inherent in the presentation of those financial statements cannot be delegated to the auditor or to anyone else. Depending on the facts, some of the services that will not impair an auditor's independence when providing accounting application assistance to an audit client are:*
>
> > *Discussing the requirements and the related concepts, terminology and implementation issues related to an accounting application*
> > *Providing sample journal entries that help management understand the accounting application*
> > *Discussing factors to be considered in making judgments that may become critical in the accounting process*
> > *Discussing the nature of relevant model inputs and related market sources of information*
>
> *In general the staff believes that the auditor may provide advice to the audit client on the proper application of accounting and assist him or her in gaining an understanding of the methods, models, assumptions and inputs used by such accounting application or standard."*

— 604.18 A1

We suggest the Board's intent with regard to "valuation being subject to external review" at 604.18 A1 be more clearly stated to indicate, for example, that the valuation, as incorporated in a tax return or other filing, is subject to review, not that the valuation itself or the tax return or other filing must be reviewed.

— 604.21 A1

604.21 A1 indicates the services might create a self-review threat, but does not state "when the results of the services will affect the accounting records or the financial statements on which the firm will express an opinion." Omission of this statement seems inconsistent with the presentation of this threat awareness throughout Section 600 (e.g., 604.3 A1, 604.17 A1 and 607.3 A1).

— R604.24

In conjunction with the new prohibition at R604.24, it would be beneficial to provide an example of when assisting in the resolution of a tax dispute would create a self-review threat, similar to the example given for litigation services.

— 610.4 A1

We suggest deleting the third bullet point under 610.4 A1 as this factor is now a prohibited service for all audit clients as stated at R610.6.

— Subsection 610

The inclusion of due diligence services within the definition of corporate finance services in subsection 610 is inconsistent with both market practice and market understanding of corporate finance services, and has the potential to confuse TCWG. We think there is significant merit in the approach elsewhere in the specific subsections to Section 600 of grouping services with similar independence characteristics together to assist TCWG in more readily understanding the threats to independence. However, the objective nature of traditional due diligence services generally does not create a self-review or advocacy threat, and is therefore not aligned with the profile of corporate finance services, introducing inconsistency in the approach. We recommend that due diligence services be excluded from the description of corporate finance services. Due diligence services are effectively covered by Advice and Recommendations in 600.12 A1 or in Valuations in subsection 603.

We believe the EU regulations should be considered related to the permissibility of due diligence services. Article 8 of the 2014 EU regulation – REGULATION (EU) No 537/2014 – states: "Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity should be prohibited except the provision of services such as due diligence services, issuing comfort letters in connection with prospectuses issued by the audited entity and other assurance services."

As an alternative to excluding due diligence from Section 610, we suggest the addition of application guidance that would indicate that performing objective due diligence services in relation to potential acquisitions and disposals will not create self-review or advocacy threats.

11. ***Do you support the proposed consequential amendments to Section 950?***

The proposed application guidance in 950.9 A2 encourages disclosing the existence of a self-review threat and the steps taken to address the threat to the intended user when an assurance engagement is undertaken for a PIE and the results of the engagement are provided to an entity or organization established by law or regulation to oversee the operation of a business sector or activity. We believe that such disclosures are not meaningful given the firm's ultimate conclusion they are independent. In many cases, intended users may not understand the context or purpose of such a disclosure, potentially causing them to unnecessarily question the independence of the assurance firm and the validity of the assurance report. Although such disclosures are only encouraged and not required, we do not agree with the necessity of retaining such a recommendation in the Code. If the application material is retained, it should be expanded to discuss how and where such disclosure should be made, and whether such disclosure should be made only to the related regulatory body or to all users of the assurance report.

12. ***Are there any other sections of the Code that warrant a conforming change as a result of the NAS project?***

Relative to the requirement in R400.32, we suggest non-authoritative guidance to clarify two points:

- Under (a), when would tax planning be considered "subject to auditing procedures" and
- Does the specification of "another firm" under (c) allow for an in-network firm to perform the engagement contemplated?