

4 June 2020

Stavros Thomadakis
Chair
International Ethics Standards Board for Accountants
539 Fifth Avenue
New York, 10017
USA

Dear Stavros,

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

Thank you for the opportunity to comment on the IESBA exposure draft *Proposed Revisions to the Non-Assurance Services Provisions of the Code*. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB).

The External Reporting Board (XRB) is a Crown Entity responsible for developing and issuing accounting and auditing and assurance standards including professional and ethical standards in New Zealand. The XRB's outcome goal is to contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance framework that engenders confidence in New Zealand financial reporting, assists entities to compete internationally and enhances entities' accountability to stakeholders. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards, including ethical standards and standards for related services.

The NZAuASB supports the IESBA's objective to ensure that all NAS provisions in the International Independence Standards are robust and of high quality for global application, thereby increasing confidence in the independence of audit firms. The proposal to prohibit non assurance services to audit clients that are public interest entities is a step in the right direction, however, the NZAuASB questions whether the proposals go far enough.

In order to address the perception that the provision of non-assurance services impairs independence, a fundamental change in the Code is required. It is unlikely that all users of the financial statements will understand and appreciate the nuances of the different threats to independence considered by the firm in determining whether to accept an engagement. While the NZAuASB strongly supports the requirement, for public interest entities, to obtain concurrence from those charged with governance for the provision of non-assurance services, leaving the assessment of independence under the Code to be made by the firm, we are concerned that this may not be enough to address external perceptions about the lack of independence even with ongoing regulator oversight.

In New Zealand, the Auditor-General has recently taken the approach of requiring appointed auditors and firms to apply a more stringent test when assessing independence in appearance with regard to non-assurance work, and additional work of an assurance nature, for public sector entities (many of which are also public interest entities under the New Zealand definition). The application of the test by appointed auditors and firms will be monitored and overseen by the Auditor-General's office.

The NZAuASB believes this approach should also now influence the global position. The approach suggests that, in order to effect the necessary change in perception and ensure independence in appearance as well as in fact, all non-assurance services to audit clients that are public interest entities should be prohibited.

The NZAuASB's responses to the detailed questions raised in the explanatory memorandum are set out in the attachment.

In formulating this response, the NZAuASB sought input from New Zealand constituents, including the profession, the supreme audit institution, and the regulator.

Should you have any queries concerning our submission please contact Sylvia van Dyk, Director – Assurance Standards, at sylvia.vandyk@xrb.govt.nz.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'April Mackenzie', with a horizontal line extending to the right.

April Mackenzie
Chief Executive
External Reporting Board

Attachment: Submission of the New Zealand Auditing and Assurance Standards Board

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

Schedule of Responses to the IESBA's Request for Specific Comments

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

Response:

The self-review threat is only one of five threats to compliance with the fundamental principles and independence identified in the conceptual framework. Singling out the self-review threat creates a hierarchy of threats where the self-review threat appears to be more important than the other threats. There is a risk that the firm will focus its considerations on whether a self-review threat would be created, which may lead the firm to inappropriately accept an engagement to perform a non-assurance service where another type of threat, for example, an advocacy threat or a familiarity threat, exists.

While establishing a prohibition on providing a non-assurance service that creates a self-review threat to an audit client that is a public interest entity is a step in the right direction, the NZAuASB questions whether the prohibition goes far enough. There is a widespread perception, both globally and in this jurisdiction, that performing non-assurance services for an audit client that is a public interest entity impairs the auditor's independence. Those that hold this view do not necessarily distinguish between the different types of threats identified in the conceptual framework, i.e., it does not matter whether the threat to independence arises due to a self-interest threat, an advocacy threat, or one of the other types of threats.

The NZAuASB recognises and supports the new requirements to strengthen communications with those charged with governance about non-assurance matters, in particular, for public interest entities, the requirement to obtain concurrence from those charged with governance for the provision of non-assurance services. However, the NZAuASB is concerned that this might not be enough to address external perceptions of a lack of independence, even with ongoing regulatory oversight of the firm's judgements under the Code.

Changing these perceptions about auditor independence will require bold change. The perception of independence (i.e., independence in appearance) should be a vital component of any auditor's independence. In New Zealand, independence in appearance is now a matter that those who carry out work on behalf of the New Zealand Auditor-General (including private sector firms) are required to take into account when assessing their independence¹. This assessment requires consideration of a how a particular situation would look from the perspective of a reasonable and informed third party with publicly available information. As a result, non-assurance services are prohibited and additional work, over and above the work that is required (or permitted), is limited to "work of an assurance nature". Where the value of the additional work becomes significant when compared to the audit fee, further consideration is required and the application of the reasonable and informed third party test may further limit the amount of additional work that can be performed.

The NZAuASB believes this approach should also now influence the global position. Accordingly, the NZAuASB recommends that in order to ensure independence in appearance, the provision of non-

¹ Many public sector entities are also public interest entities under the New Zealand definition

assurance services to an audit client that is a public interest entity should be prohibited. Such a prohibition would establish consistency in practice and remove any “grey area” of judgement by the firm which might be open to question by users. Further, it would remove the need to establish “black lists” of prohibited services or “white lists” of permitted services.

- 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?**

Response:

As noted in the response to question 1, the NZAuASB recommends the prohibition of non-assurance services to audit clients that are public interest entities. In such circumstances, this application paragraph would be unnecessary. Should the IESBA determine to proceed with the changes as exposed, the NZAuASB is generally supportive of the application material, however, we do consider that further emphasis could be given to independence in appearance. As noted in the response to question 1, the perception of independence should be a vital component of any auditor’s independence and requires consideration of how a particular situation would look from the perspective of a reasonable and informed third party with publicly available information.

Our outreach with the constituency in New Zealand did not identify any additional factors to be considered. Stakeholders did question whether “and” following sub-paragraph (b) should be “or”, i.e., do all three of the factors need to be present in determining whether the provision of the non-assurance service creates a self-review threat or could the presence of only one of the factors create a self-review threat.

- 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?**

Response:

The NZAuASB is concerned that tax advisory and tax planning services are specifically scoped out of the self-review threat. As noted in the response to question 1, the NZAuASB recommends the prohibition of non-assurance services to audit clients that are public interest entities. It is the view of the NZAuASB that providing tax advisory and tax planning services to an audit client that is a public interest entity creates a self-review threat, regardless of whether one of the conditions identified in paragraph 604.12 A3 is present.

While the NZAuASB acknowledges that there may be some advantages to audit and tax services being provided by the same firm, for example, knowledge of the client, in order to change the perception that there is a lack of independence, it is important that the provision of all tax services be prohibited. Anecdotal evidence indicates that firms can receive large fees for the provision of tax services to audit clients. This, in itself, creates the perception that the firm is not independent, and the perception is reinforced by the fact that the judgement under the Code sits with the firm, despite being subject to regulatory oversight.

- 4. Having regard to the material in section II, 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?

Response:

The NZAuASB is supportive of Approach 2 as presented at the May 2020 National Standard Setters meeting, i.e., a longer more broadly defined list which local regulators may refine by tightening definitions, setting size criteria and adding or exempting certain types of entities.

Stakeholders in New Zealand are generally of the view that our broad definition of public interest entity extends well beyond the extant global position. New Zealand is not unique in this regard. The NZAuASB believes it is in the public interest to have a wider range of entities identified as public interest entities in the global standard.

The source of funding is a key factor to be considered in determining the types of entities to be included as public interest entities.

- 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")?**

Response:

Notwithstanding the view expressed in response to question 1, that the provision of non-assurance services to audit clients that are public interest entities should be prohibited, the NZAuASB supports the removal of the materiality qualifier. Outreach indicated that materiality can be a difficult concept to apply, resulting in inconsistencies in practice. The NZAuASB considers that a requirement to apply materiality considerations when obtaining the concurrence of those charged with governance would be extremely difficult and unlikely to achieve consistency.

- 6. Do you support the proposal to prohibit the following NAS for all audit clients, irrespective of materiality:**

- **Tax planning and 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)?**
- **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)?**

Response:

Yes, the NZAuASB supports the prohibition of the identified non-assurance services to all audit clients. The NZAuASB does, however, question whether the prohibition should be limited to the effectiveness of the advice being dependent on a particular accounting treatment or presentation and the audit team having doubt about the appropriateness of that treatment or presentation. As noted in the response to

question 1, the NZAuASB recommends the prohibition of all non-assurance services to audit clients that are public interest entities.

7. Do you support the proposals for improved 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)?

Response:

Notwithstanding the view expressed in question 1, that the provision of non-assurance services to audit clients that are public interest entities should be prohibited, the NZAuASB supports the proposals for improved communication with those charged with governance.

Those charged with governance are responsible for the financial statements, including ensuring that the services provided by the auditor do not impair independence. Clear communication between the auditor and those charged with governance is an important part of that responsibility. Our constituency feedback indicated that such communications are already happening in New Zealand to a large extent. Adding a requirement to the Code (while binding only on practitioners, not those charged with governance) may have a significant educational impact and could lead to this practice being more fully embraced by the director community.

Documentation, either by the auditor or those charged with governance, of the communications and decisions made demonstrates the fulfilment of those responsibilities. Obtaining the concurrence of those charged with governance will help to dispel concerns about auditor independence only if the new requirements are supported by strong public disclosure by those charged with governance, i.e., the considerations of those charged with governance need to be observable by users.

The Code needs to be clear that the concurrence of those charged with governance can only be sought if the auditor has concluded that the non-assurance service is permitted under the Code. This provision should not be used as a mechanism whereby those charged with governance provide a “waiver” to the auditor.

The NZAuASB recommends that the concurrence of those charged with governance required by paragraph R600.19 be obtained in writing.

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

Response:

The NZAuASB supports the repositioning of the provision relating to assuming a management responsibility.

Outreach indicated concerns over practical challenges around implementing the new requirement in paragraph R400.32. The firm is not always able to time its appointment to fit neatly around the requirements of the paragraph and it can be costly for the firm to engage a professional accountant to perform the required review or for the entity to engage another firm to evaluate or re-perform the procedures sufficient to take responsibility for the result of the non-assurance service. In smaller markets, firms already face challenges in managing the services provided to clients.

Further, the NZAuASB is concerned about the implications of the requirement to engage a professional accountant, who is not a member of the firm expressing the opinion, to perform a review of the first audit engagement affected by the self-review threat that is equivalent to an engagement quality review. The proposal in the Code is clear that the provision of a non-assurance service to an audit client that is a public interest entity is prohibited if a self-review threat will be created in relation to the financial statements on which the firm will express an opinion. It is the NZAuASB's view that the proposed subparagraph (b) is not an appropriate safeguard against a threat of independence in appearance. We do not consider there are any alternative safeguards available, and unless (a) or (c) are used, the firm should not accept the engagement.

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?

Response:

Yes, the NZAuASB supports the proposal to elevate the extant application material relating to the provision of multiple non-assurance services to the same audit client as a requirement and the related application material.

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

- **The concluding paragraph relating to the provision of services that are “routine or mechanical” in proposed paragraph 601.4 A1?**
- **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?**
- **The prohibition on the provision of a tax service or recommending a tax transaction if the service or transaction relates to marketing, planning or opinion in favour of a tax treatment, and a significant purpose of the tax treatment or transaction is tax avoidance (see proposed paragraph R604.4)?**
- **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?**

Response:

Yes, the NZAuASB supports the proposed revisions identified in question 10.

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

Response:

The NZAuASB considers that the proposed amendments to Section 950 could be more robust, and encourages the IESBA to consider further whether certain non-assurance services provided to an assurance client that is a public interest entity should be prohibited. In particular, the NZAuASB

considers the firm's consideration of multiple non-assurance services provided to an assurance client in paragraph 950.7 A1 should be elevated to a requirement consistent with R600.10.

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

Response:

The NZAuASB has not identified any other sections of the Code that warrant conforming change as the result of the IESBA's non-assurance services project.