

# SUMMARY: BENCHMARKING INTERNATIONAL INDEPENDENCE STANDARDS

## PHASE 1 REPORT – COMPARISON OF IESBA AND US SEC/ PCAOB INDEPENDENCE FRAMEWORKS



This publication is issued by the Staff of the International Ethics Standards Board for Accountants® (IESBA®). It is intended to respond the questions regarding the comparability of the provisions of the *International Code of Ethics for Professional Accountants (including the International Independence Standard)* (the 'Code') applicable to audits of public interest entities (PIE) against the independence requirements for entities subject to the US Securities and Exchange Commission (SEC/ the Commission) and the US Public Company Accounting Oversight Board (PCAOB).

This Report does not amend or override the Code or the SEC and PCAOB rules, the texts of which alone are authoritative, and does not constitute an authoritative or official pronouncement of the IESBA.

Reading this Report is not a substitute for reading the Code or the SEC and PCAOB rules. Readers are also cautioned to apply judgment in reading and interpreting this Report within the context of their jurisdiction.

# I. INTRODUCTION

1. The [\*Benchmarking International Independence Standards Phase 1 Report\*](#) (the Final Report) compares the provisions of the *International Code of Ethics for Professional Accountants (including the International Independence Standard)* (the 'Code'),<sup>1</sup> especially the International Independence Standards (IIS) applicable to public interest entities (PIEs)<sup>2</sup> with the independence requirements for entities that are subject to the US Securities and Exchange Commission (SEC) and the US Public Company Accounting Oversight Board (PCAOB) (collectively "SEC/PCAOB"). The Final Report focuses primarily on the independence requirements of the SEC and refers to the PCAOB independence requirements only where those requirements are incremental to those of the SEC rules.
2. This Summary Report and the Final Report do not include all the aspects and conditions of the Code or the SEC and PCAOB rules. They are not interpretations of the relevant provisions/ rules and should not be viewed as such. The reports refer to the relevant provisions/r ules to the extent it is necessary from the point of view of the IESBA Staff's comparison. For the background and the purpose of Phase 1 of the benchmarking initiative please see [Section I, A and B in the Final Report](#).
3. Given the objective of the initiative, the Final Report addresses the focus areas and topics of greatest interest to the IESBA, users of the Code and other stakeholders. It reflects the IESBA Staff's understanding of the respective frameworks being compared, and it was developed with the benefit of input from the IESBA's Benchmarking Working Group and the IESBA.

**[This summary is based on the analysis and commentary in the accompanying detailed report, \*Benchmarking International Independence Standards Phase 1 Report\*.](#)**

4. This Summary Report provides an overview of the key similarities and differences between the frameworks based on the analysis in the Final Report that includes the specific references to relevant Code's provisions and the SEC and PCAOB rules.
5. The IESBA Staff has highlighted a number of differences between the Code's provisions relevant to the audit of PIE audit clients and the SEC/PCAOB independence rules that Staff believes might result in practice in different outcomes regarding the prohibition or permissibility of services or relationships to an audit client.



**These differences are indicated within this document via icon and blue line.**

<sup>1</sup> The benchmarking is based on the 2021 edition of the IESBA Handbook, including revisions that will become effective in December 2022 (i.e., revisions relating to the objectivity of an engagement quality reviewer and other appropriate reviewers, and the revised non-assurance service (NAS) and fee-related provisions of the Code).

To access the Code and to obtain final pronouncements issued subsequent to April 2021, visit the IESBA's website at: [www.ethicsboard.org/standards-pronouncements](http://www.ethicsboard.org/standards-pronouncements).

<sup>2</sup> The IESBA unanimously approved revisions to the Code's definition of a PIE in December 2021. The final pronouncement was released in April 2022 and is available on the [IESBA's website](#). The revised PIE definition will become effective in December 2024.

## II. OVERARCHING PRINCIPLES AND APPROACH

6. The Code and the SEC rules were developed to apply in different jurisdictions which result in different approaches in terms of applicability and use. Accordingly, the two frameworks follow different conceptual approaches as described in **Section II, A-B in the Final Report**.
7. Despite the difference in the approach, neither the Code nor the SEC framework is entirely “rules-based” or entirely “principles-based”. Both frameworks include overarching principles that are supported with specific requirements.
8. Under both the Code and the SEC rules the determination of “independence” requires consideration of (i) independence in mind/ in fact and (ii) independence in appearance; in addition, the “reasonable and informed third party” test / “reasonable investor with knowledge of all relevant facts and circumstances” test has a significant role in the assessment of a firm’s independence.
9. Under the Code, five fundamental principles – Integrity, Objectivity, Professional Competence and Due Care, Confidentiality and Professional Behavior – establish the standards of behavior expected of all professional accountants. The Code also provides a conceptual framework that professional accountants are expected to apply to comply with those fundamental principles. That framework, involves identifying, evaluating and addressing threats to compliance with the fundamental principles. The Code’s conceptual framework also applies to independence.
10. Under the SEC rules, a general standard of auditor independence is established by Rule 2-01(b). It provides that:
 

***“The [Securities and Exchange] Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant’s engagement.”***
11. Both frameworks specify the fundamental objectives (or principles) by which an auditor’s independence should be assessed. The table below provides a comparison of high-level concepts or overarching principles from each framework.

<b>THE CODE</b> Requires professional accountants to address the following threats	<b>SEC RULE 2-01</b> The SEC Introductory Note <sup>3</sup> states that the SEC “looks in the first instance to whether a relationship or the provision of a service”:
<b>Self-interest threat</b> – the threat that a financial or other interest will inappropriately influence a professional accountant’s judgment or behavior.	Creates a <b>mutual or conflicting interest</b> between the accountant and the audit client
<b>Familiarity threat</b> – the threat that due to a long or close relationship with a client, or employing organization, a professional accountant will be too sympathetic to their interests or too accepting of their work.	
<b>Intimidation threat</b> – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.	
<b>Conflict of interest</b> – A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.	
<b>Self-review threat</b> – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the accountant, or by another individual within the accountant’s firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity.	Places the accountant in the position of <b>auditing his or her own work</b> .
A firm or a network firm shall not assume a <b>management responsibility</b> for an audit client.	Results in the accountant <b>acting as management</b> or an employee of the audit client
<b>Advocacy threat</b> – the threat that a professional accountant will promote a client’s or employing organization’s position to the point that the accountant’s objectivity is compromised;	Places the accountant in a position of <b>being an advocate</b> for the audit client.

<sup>3</sup> SEC’s Rule 2-01 Introductory Note sets out that “the rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in §210.2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service:”

### A. *Evaluating Compliance with the Overarching Principles*



12. Although both frameworks set out similar fundamental objectives (or principles), the assessment and the application of those principles are different in the two independence frameworks. Provided that a proposed service or relationship is not explicitly prohibited,
  - (a) The conceptual framework in the Code focuses on the possibility that a service or relationship might give rise to a threat – and then on whether that potential threat is at or can be reduced to an acceptable level by the application of safeguards. The service or relationship is prohibited if the threat cannot be eliminated or reduced to an acceptable level.
  - (b) In contrast, the SEC rules do not permit safeguards to address situations where a service or relationship would otherwise breach the overarching principles. As a result, an accountant's assessment focuses on whether any of the overarching principles would be breached and, if it would, the accountant is prohibited from providing that service.

An all-encompassing comparative evaluation is, therefore, not possible as much will turn on the specific circumstances.

### B. *Management Responsibility/Acting as Management*

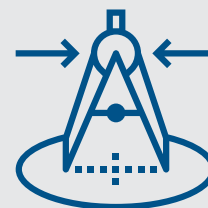


13. While both frameworks prohibit a firm assuming management responsibility/ an accountant from acting as management for an audit client, the approaches in the Code and in the SEC rules differ.
  - (a) The Code focuses on ensuring that the client's management is taking responsibility for the decisions relating to the services being provided that are properly the responsibility of management. Provided management does take such responsibility (as demonstrated based on criteria set out in the Code), the firm is permitted to provide the services concerned.
  - (b) The SEC rules prohibit the provision of services which the SEC regards as being the proper function of management – including providing services or undertaking activities that would ordinarily be undertaken by an employee of an audit client. The prohibition applies irrespective of any arrangements that might be in place to ensure that management takes responsibility for decisions relating to such services.
14. The NAS provisions of the Code provides as an exception for a firm or a network firm to assume management responsibilities in respect of certain related entities of an audit client if the firm or network firm meets very specific conditions. The SEC does not allow for any exceptions under the prohibition from acting as management.
15. As an overarching principle, the SEC rules also prohibit an accountant from acting as an employee to an audit client.

### Non Compliance with Laws and Regulations

Although not part of the IIS, the Code establishes the public interest expectation for how professional accountants, including those engaged to perform audits of financial statements, should respond when they become aware of, or suspect, non-compliance with laws and regulations (NOCLAR).

The topic of responding to NOCLAR is part of the Code's framework, and is dealt with comprehensively. Although NOCLAR is not explicitly addressed in the SEC or PCAOB independence rules, similar requirements are included in US laws and auditing standards. In particular:



- The Code's provisions apply to all professional accountants, including auditors, and provide guidance on how to address the position if the actual or suspected breach of law or regulation is of such significance as to require action in the public interest.
- The Securities Exchange Act of 1934 and PCAOB auditing standards address the auditor's responsibility with respect to illegal acts focusing mainly on their effect on the financial statements.

## III. KEY DEFINITIONS

16. A comparison of the key definitions is central to any benchmarking of the Code to the SEC/ PCAOB rules. The Final Report includes the detailed description and the comparisons of the key definitions in **Section III of the Final Report**.

17. The Final Report notes the following differences in those definitions that can materially affect the ambit and application of the frameworks' substantive provisions.



- (a) **Related Entities/ Affiliates of the Audit Client:** Whilst substantially similar, there are two notable differences between the definitions of 'related entities' in the Code and 'affiliates' in the SEC rules:
  - The Code excludes entities that control an audit client if the audit client is immaterial to the controlling entity, whereas SEC rules include them; and
  - The Code includes relationships that result in significant influence only if that influence arises from a direct financial interest; the SEC rules apply irrespective of how that significant influence arises.
- (b) **Investment Company Complexes:** The SEC rules define investment company complexes and address which companies within an investment company complex are considered affiliates of an audit client. The position of investment company complexes is not addressed in the Code.

- (c) **Network Firm/Associated Entities:** The SEC rules do not address specifically the position of network firms. However, the definition of an “accounting firm” includes the accounting firm’s “associated entities”.
- As the SEC rules do not define “associated entities” and the SEC Staff’s practice is to have regard to all the relevant facts and circumstances when applying its definition of an “accounting firm”, it is not possible to provide a definitive list of entities that the SEC would regard as being within the definition of an accounting firm.
  - Both frameworks appear to have a comparable objective – namely to address the position of those firms which are required to be independent of an audit client. However, practice in the US might extend the application of the SEC definition to entities that might not be regarded as network firms under the Code.
- (d) **Audit Team/ Covered Persons:** When comparing the provisions of the Code and the SEC rules, it is relevant to note that the Code generally focuses on the audit team as the base, while the corresponding SEC rules apply to “covered persons” as well as to the members of the audit engagement team or chain of command. The approach taken by the SEC results in the SEC rules being applicable to individuals who are not addressed in the Code’s audit team definition, namely:
- Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of non-audit services to the audit client in the relevant time period, and
  - Any other partner, principal, or shareholder from an “office” of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.
- (e) **Key Audit Partner/ Audit Partner:** The Code and the SEC rules adopt the same approach when defining a “key audit partner” (in the Code) and an “audit partner” (in the SEC rules). Both frameworks include the same categories of individuals, namely (a) the engagement partner/lead partner (b) the engagement quality reviewer, and (c) other audit partners who make key decisions or judgments on significant matters with respect to the audit.
- However, the SEC definition of other audit partners (in category (c) above) includes
- Other partners on the engagement team who maintain regular contact with management and the audit committee, and
  - Other audit engagement team partners who provide more than ten hours of audit, review, or attest services in connection with the annual or interim consolidated financial statements of the issuer or an investment company.



## IV. SUMMARY OF COMPARISONS OF FOCUS AREAS AND TOPICS

### Fee-related Provisions<sup>4</sup>

#### A. Fees Paid by an Audit Client and Total Fees



18. The Code does not seek to determine the level of fees that might be appropriate. However, it does include detailed guidance and requirements in relation to the level of fees, the total amount of fees, and fee-dependency. These issues are not addressed by the SEC and PCAOB ethics and independence rules.<sup>5</sup>

#### B. Contingent Fees



19. Both frameworks prohibit firms from charging contingent fees for audit or other assurance engagements.
20. While the SEC rules also prohibit an accountant from charging a contingent fee for any other service or product provided to an audit client, the Code:
- Prohibits charging contingent fees for a NAS provided to an audit client only if certain conditions are met, e.g., that fee is material to the firm/ network firm or if outcome/ fee is dependent on decision regarding a material amount in the financial statements;
  - Requires firms to apply the conceptual framework to identify, evaluate and address threats to independence that might be created by charging contingent fees for the provision of a NAS to an audit client.
21. In addition, the SEC rules restrict accountants from providing services or products to an audit client for a commission. In contrast, the Code does not include a general prohibition on receiving such commissions unless the criteria for the prohibition of a contingent fee is also met. The Code identifies that the receipt of commissions creates a self-interest threat to compliance with the principles of objectivity and professional competence and due care and requires the firm to apply the conceptual framework to reduce the level of any such threat to an acceptable level.
- #### C. Overdue Fees
22. Both frameworks recognize that fees for audit and other services provided to the audit client that remain unpaid, and are material, could impact the firm's independence, and require a firm to assess the position and take appropriate action.
23. In contrast to the Code, the PCAOB requirements:
- Include no materiality threshold, and
  - Specify that a firm's independence is considered to be impaired if the fees remain unpaid more than one year prior to the date of the report issues.

<sup>4</sup> This section refers to the [Final Pronouncement: Revisions to the Fee-related Provisions of the Code](#) that will become effective in December 2022.

<sup>5</sup> However, the SEC's general standard still apply.

#### D. Transparency of Fee-related Information

24. Both the IESBA and the SEC attach importance to the public disclosure of information about fees paid to auditors for audit and other services.
25. However, given their different remits, the Code and the SEC rules establish different ways to achieve public disclosure. As a national regulator, the SEC has authority to establish requirements for the disclosure of fees by the audit client in certain public filings. In contrast, as the IESBA does not have legislative or regulatory authority in those jurisdictions that adopt the Code, the Code requires a firm:
  - (a) To promote the disclosure of fee-related information by an audit client, and
  - (b) To disclose that information in such manner as might be deemed appropriate if an audit client refuses to disclose that information.

### Provision of Non-Assurance/Non-Audit Services to Audit Clients<sup>6</sup>

#### A. General Provisions

26. The Code and the SEC rules are based on the application of the fundamental principles/ overarching principles to the provision of NAS/non-audit services to audit clients. Those principles are required to be complied with when firms provide services to audit clients that are not addressed specifically in the respective standards.
27. Under the Code, any situation where a self-review threat might exist is prohibited for PIE audit clients. For entities subject to the SEC rules there is an overarching principle that an auditor cannot be in a position (or be perceived to be in a position) of auditing his/her own work. In practice, the approach of the two frameworks is the same.<sup>7</sup>
28. Although the Code's provisions applicable to PIE audit clients and the SEC rules have a similar approach in relation to the provision of NAS/non-audit services to an audit client, in the case of NAS that might give rise to threats other than self-review, the prohibitions established by overarching principles might be regarded as more restrictive than the Code, for example, in the case of provision of NAS that might give rise to advocacy threats.
29. The prohibitions in the Code apply irrespective of the materiality of the outcome or results of the NAS on the financial statements of the audit client. The SEC rules take the same approach with respect to the relevance of materiality. However, in the Code materiality is relevant only when evaluating threats and determining whether safeguards reduce any threat to an acceptable level.
30. Both the Code and the SEC rules provide an exception to NAS/non-audit services prohibitions if the result of the service that is provided to certain related entities/ affiliates will not be subject to audit procedures during an audit of the client's financial statements (and requirements regarding the other overarching principles are met). The only exception is that the exception in the Code applies to all prohibited NAS, whilst the "not subject to audit exception" under the SEC framework is applicable only to "five specific prohibited services" (i.e., bookkeeping or other services related to the accounting records or financial statements of the audit client, financial information systems design and implementation, appraisal or valuation services, fairness opinions, or contribution-in-kind reports, actuarial services, internal audit outsourcing).

<sup>6</sup> This section includes the [Final Pronouncement: Revisions to the Non-Assurance Services Provisions of the Code](#) that will become effective in December 2022.

<sup>7</sup> As an exception to the general self-review prohibition, the Code permits the provision of advice and recommendations in relation to information or matters arising in the course of an audit. The SEC rules do not specifically prohibit providing advice and recommendations, and SEC guidance and releases include examples of specific situations where providing advice and recommendations to an audit client might not impair the accountant's independence.

*B. Provisions Addressing Specific Non-Assurance/Non-Audit Services*

31. Given the similar overarching principles governing the provision of NAS/non-audit services to an audit client, as presented in [Section C in the Final Report](#), the Code and the SEC or PCAOB rules address the similar concerns in substantially equivalent manner in relation to the following services:

- Accounting and bookkeeping
- Aggressive tax advice and transactions
- Tax return preparation
- Tax planning and tax advisory
- Tax services involving valuations
- Preparation of tax calculations
- Assistance in the Resolution of Tax Disputes
- Internal Audit Services



32. As explained in paragraph 28 above, the prohibitions established in the SEC rules by overarching principles might be regarded as more restrictive than the Code. For example, this might result in a different approach, especially in relation to valuation services or corporate finance services, that might give rise to advocacy threat.

However, the provisions prohibiting certain NAS that would create an advocacy threat combined with the self-review threat prohibition will reduce the range of services giving rise to an advocacy threat that a firm may still provide. Therefore, the outcome under the Code is not likely to be substantively different from that under the SEC rules.

33. The Final Report highlights the following differences regarding the provision of specific NAS/non-audit services:

- (a) **Administrative Services.** The Code permits the provision of administrative services that involve firms assisting audit clients with routine or mechanical tasks within the normal course of operations unless a self-review threat might be created. Although the SEC rules do not address the provision of administrative services to an audit client, they prohibit an accountant from acting as an employee of an audit client.
- (b) **Confidential Transactions.** While the PCAOB rules prohibit the provision of certain non-audit services related to a confidential transaction<sup>8</sup> to an audit client, the Code does not address such services, except through the conceptual framework.
- (c) **Tax Services for Persons in Financial Reporting Oversight Roles.** The PCAOB rules prohibit the provision of tax services to certain persons who are in financial reporting oversight roles. The Code does not include an equivalent provision. However, based on the application of the conceptual framework, the IESBA Staff is of the view that a firm would consider whether the provision of a tax service to a person in a financial reporting oversight role at an audit client creates threats to independence and the fundamental principle of objectivity.
- (d) **Information Technology (IT) System Services:** The Code and the SEC intend to address similar concerns and achieve equivalent outcomes regarding IT system services. However, the practice based on the SEC release regarding provision of advice and recommendation in conjunction with the design and installation of an IT systems might differ from the Code's provisions.<sup>9</sup>

<sup>8</sup> Confidential transaction is a transaction offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a fee.

<sup>9</sup> This is because the Code only allows the provision of advice and recommendations to a PIE audit client that might give rise to a self-review threat if the recommendations are provided in relation to information or matters arising in the course of an audit.



- (e) **Litigation support services.** The Code prohibits the provision of litigation support services that might create a self-review threat. It also prohibits an accountant from acting as an expert witness for an audit client unless appointed by the court or tribunal, or acting in relation to certain class actions. The SEC prohibition extends to the provision of any kind of expert services for the purpose of advocating an audit client's interest.
- (f) **Legal services.** The Code focuses on specific types of legal services<sup>10</sup> and does not establish a general prohibition on the provision of legal services by firms to their audit clients. In contrast, the SEC rules restrict the provision of any legal service that could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided.
- (g) **Recruiting/ human resources services.** The prohibitions regarding recruiting/ human resources services in the SEC rules and in the Code mainly cover the same types of services, with a few differences; for example:
  - The SEC rules prohibit accountants from engaging in psychological testing, or other formal testing or evaluation programs for the audit client. In contrast, these services are not explicitly prohibited under the Code's provisions.
  - While the SEC rules prohibit an accountant from recommending or advising an audit client to hire a specific candidate for a position, the equivalent Code prohibition applies only if such services relate to the engagement of directors, officers, or specific members of senior management.
- (h) **Corporate finance services.** Both frameworks prohibit corporate finance services that:
  - Involve promoting, dealing in, or underwriting the shares, debt or other financial instruments issued by the audit client – including acting as a broker-dealer – or providing advice on investment in such shares, debt or other financial instruments., and
  - Services that might create a self-review threat.

The SEC rules and PCAOB requirements also prohibit the provision of a number of specific services. For example, the SEC prohibits having custody of assets of the audit client. While the Code does not include such a prohibition, firms have to apply the conceptual framework to determine whether such service is permissible or not under the particular circumstances.

<sup>10</sup> The Code prohibits:

- Provision of legal advice if that advice might create a self-review threat;
- A partner or employee of the firm or the network firm serving as a General Counsel; or
- Acting in an advocacy role for an audit client in resolving a dispute or litigation before a court or tribunal.

## Auditors' Communication with Those Charged With Governance (TCWG)

### A. Communication of Independence Matters

34. Both frameworks address auditors' communication with TCWG or the audit committee about any relationships and other matters that might reasonably bear on independence and so enable TCWG to assess the firm's independence. The PCAOB rules also specify the timing, form and manner in which the communication is to be documented.
35. The Code contains detailed guidance regarding communication of fee-related information to enable TCWG to consider whether any independence considerations arise from the scale or nature of such fees. The SEC and PCAOB rules do not address in general the communication of fee-related matters to audit committees. However, SEC rules also require the disclosure of fees and the pre-approval of audit and permitted NAS and as part of that process, the level of fees might be considered by the audit committee.

### B. Approval of Provision of NAS/Non-audit Services to an Audit Client

36. Both frameworks require a firm to obtain the concurrence or approval of TCWG before a NAS/non-audit services may be provided to an audit client. Such concurrence or approval must be obtained for each proposed NAS individually or under a general, predetermined policy agreed between the firm and TCWG.
37. Arising from the different conceptual approaches, there are some differences between the approach taken by the two frameworks:
  - (a) The SEC rules require the audit committee to actually pre-approve the service, while the Code requires TCWG to concur with the firm's assessments of any impact on independence and agree with the provision of the service.
  - (b) The SEC rules require accountants to seek approval before providing any audit, as well as non-audit service. The Code requirements are applicable only to the provision of NAS.
  - (c) The SEC rules require pre-approval from the audit committee of the issuer if a service is to be provided to the issuer or its subsidiaries. Similarly, the Code requires obtaining concurrence from TCWG prior to the provision of NAS to the PIE and any controlled entities. The Code, however, extends this requirement to the provision of services to parent entities of that PIE.
  - (d) The SEC rules specifically address pre-approval of services provided to investment company complexes. As the Code does not address investment company complexes, it does not include such a requirement.
  - (e) The SEC rules provide a de minimis exception to the pre-approval requirements for the provision of services other than audit, review or attest services provided that the audit committee approves the service prior to completion of the audit. The Code does not include any such de minimis threshold.<sup>11</sup>
  - (f) The Code's provisions address a situation where the provision of information in relation to the NAS would result in disclosure of sensitive or confidential information or it would be prohibited under national laws and regulations. Such provisions are not required where a framework - such as the SEC/PCAOB rules - has legal or regulatory standing in a particular jurisdiction.



<sup>11</sup> The Code does not include a de minimis threshold because the IESBA concluded that the Code's provisions regarding breaches are appropriate to address inadvertent breaches arising from the application of the requirements for firm communication with TCWG about NAS-related matters.

## Financial Relationships

38. Both the Code and the SEC rules include provisions addressing a range of financial relationships that might occur involving an audit firm and an audit client. The application of the SEC rules tends to be broader due to differences in the individuals or entities to which the provisions apply, as explained in paragraph 17(d) in this Summary Report.

### A. *Financial Interests in an Audit Client*

39. The Code and the SEC rules contain similar prohibition if firms, network firms, audit team members/ covered persons and their immediate family members hold:

- A direct or material indirect interest in an audit client.<sup>12</sup>
- Any financial interests in an audit client by way of trust.
- However, the prohibition in the Code only applies if the interest in the audit client held by the trust is material to the trust and/or if the relevant person is also a beneficiary of the trust.
- Interests in an audit client through an intermediary investor or common investee with the audit client.

### B. *Loans and Guarantees*

40. The Code and the SEC rules includes prohibition for firms, audit team members and their immediate family members from accepting loans and making or guaranteeing loans to an audit client under different conditions. However, the prohibitions under the two frameworks differ as follows:

- (a) The Code only prohibits accepting loans from an audit client if it is not a bank (or equivalent) and sets out specific guidance for loans from banks. (See paragraph 41 below)
- (b) The prohibitions in the Code apply if the loan is material to both the firm, audit team member or immediate family member, as applicable, and the audit client.
- (c) The SEC prohibitions extend to loans from or to the audit client's officers and directors or to beneficial owners of the audit client's securities who have significant influence over the audit client.

41. The Code allows firms, network firms, audit team members and their immediate family members to accept a loan from, and have deposits with or a brokerage account with an audit client that is a bank or similar institution provided it is made on normal lending/ commercial terms and conditions. In comparison, the SEC rules prohibit an accounting firm, covered persons of the firm and their immediate family members from having:

- Loans from any audit client other than certain specified types of loans from a financial institution obtained under its normal lending procedures, terms, and requirements.
- Accounts with banks and similar institutions that are audit clients that exceed a certain threshold
- Any aggregate consumer loan balance owed to an audit client if it is not reduced to a specific amount.:
- Accounts with a broker-dealer that is an audit client that exceed a certain threshold.

<sup>12</sup> Although there are differences between the definitions of audit team members in the Code and covered person in the SEC rules, this prohibition applies, under both frameworks, to partners in the office in which an engagement partner practices in connection with the audit engagement, and certain partners or managerial employees who provide non-audit services to the audit client

### C. Other Financial Relationships

42. The SEC rules prohibit an accounting firm, any covered person in the firm, or any of his or her immediate family members from having:
- Any futures, commodity, or similar account maintained with a futures commission merchant that is an audit client.
  - Any individual insurance policy issued by an insurer that is an audit client unless:
    - The policy was obtained at a time when the covered person in the firm was not a covered person in the firm; and
    - The likelihood of the insurer becoming insolvent is remote.

Although the Code does not address these other financial relationships with the audit client, the fundamental principles and the conceptual framework apply.

### Business Relationships



43. Both frameworks include prohibitions regarding business relationships between the firm or audit team members/ covered persons and the audit client or the management/ persons associated with the audit client in a decision-making capacity. However, the approaches of the Code and the SEC rules differ in certain regards:
- The SEC rules prohibit any direct and material indirect business relationships. In contrast, the Code only restricts close business relationships where the financial interest is material and the business relationship is significant.
  - The restriction under the Code only includes the audit client and management, whereas the SEC restriction also captures beneficial owners with significant influence.
44. Although the SEC rules do not specifically address business relationships created by financial interest held in common with the audit client or its management, audit firms would need to comply with the financial relationships requirements and the general standard.
45. Both the SEC rules and the Code provide an exception to business relationship prohibitions in relation to the purchase of goods and services from an audit client by a firm, an audit team member/ covered persons (or as a consumer under the SEC rules) in the ordinary/ normal course of business.

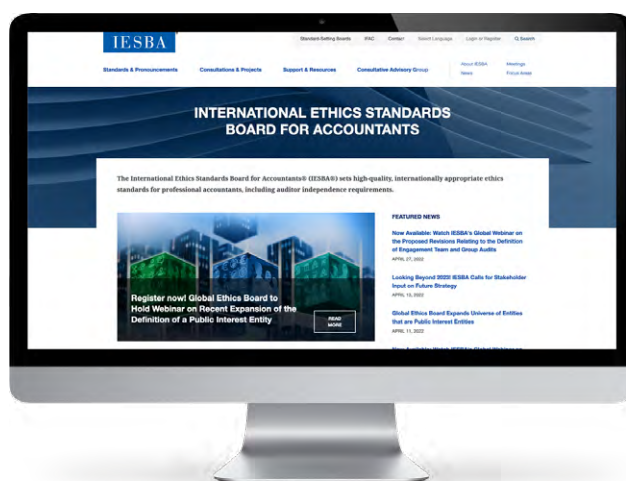
### Partner Rotation/Long Association

46. Although only the Code includes detailed guidance regarding the broader concept of the threats to independence created by long association of audit team members with the audit client, both standards include requirements regarding audit partner rotation.
47. Both frameworks address the position of (a) Audit Engagement Partners, (b) Engagement Quality Review Partners and (c) Other Audit Partners. The individuals within categories (a) and (b) are the same under the Code and the SEC rules. The Code and the SEC rules include key audit partners/ audit partners; but the SEC rules include other partners if they have a significant role in relation to the audit entity's financial statements, as described in paragraph 17 (e) in this Summary Report.

48. Both frameworks specify the cumulative period that a partner in one of those categories
- May hold such positions before rotating off the engagement ('time-on'). The Code permits a maximum period of 7 cumulative years for all categories; the SEC rules permit those partners in categories (a) and (b) to be involved for 5 cumulative years and those in category (c) for 7 cumulative years.
  - Must serve a "cooling-off" period. Both the Code and the SEC rules require cooling-off periods of 5 consecutive years for those in category (a) and 2 consecutive years for those in category (c). Those in category (b) are required to cool-off for 3 consecutive years under the Code and 5 consecutive years under the SEC rules.

## Gifts and Hospitality

49. Both frameworks recognize that giving or accepting gifts and other inducements to or from an audit client could impact the firm's independence. The Code and the PCAOB rules prohibit the firm or audit team members from accepting any of such gifts, unless the value is trivial and inconsequential. However, the Code includes more specific guidance and general prohibitions from offering inducements to an audit client or encouraging others to accept or offer inducement.



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