

August 15, 2014

Small and Medium Practices Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft *Proposed Changes to Certain Provisions of the Code Addressing Non-Assurance Services for Audit Clients*

INTRODUCTION

The Small and Medium Practices Committee is pleased to respond to the IESBA on this Exposure Draft (ED).

The SMP Committee is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMP Committee are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies from 18 countries from all regions of the world.

GENERAL COMMENTS

In principle, we support the IESBA (the Board) work in this area and the proposals to bring greater clarity to the provision on Non-Assurance Services within the *IESBA Code of Ethics for Professional Accountants* (the Code). We note that we have already provided comments to the IESBA Non-Assurance Services Task Force in response to the Agenda Items in April 2014.

The proposal that the effective date for the changes will not be less than 12 months after the issuance of the final changes is considered acceptable. In our opinion, this is the minimum time period that should be considered to ensure effective implementation of the changes. We would also recommend that the Board consider whether it would be more practical for these changes to be introduced as part of other significant changes resulting from other current projects (for example, Long Association) and their effective dates coordinated. Keeping up with new regulations and standards has been consistently ranked as one of the top challenges facing SMPs in the Quick Poll surveys conducted by IFAC¹. This finding supports the view that the Code should not continually be changed, but rather there is a stable platform for adoption and implementation for a period of time.

We have outlined below our detailed comments in response to the questions raised in the ED.

¹ *IFAC SMP Quick Poll: Year-end Round-up 2013* (see <http://www.ifac.org/publications-resources/ifac-smp-quick-poll-2013-year-end-round>)



SPECIFIC COMMENTS

Emergency Provisions

1. *Are there any situations that warrant retention of the emergency exceptions pertaining to bookkeeping and taxation services?*

We believe that there may be situations that warrant the retention of the emergency exceptions pertaining to bookkeeping and taxation services or further amendments should be made to the Code which would allow the provision of such services for a short period of time in emergency situations.

Public-interest entities (PIEs) vary considerably around the world in terms of their size and thus the degree of sophistication/ level of resources of their respective accounting departments. Whilst the proposals may be acceptable in the context of some PIEs, for example a large bank in a developed nation, they could pose practical issues in the context of, for example, a very small charity in a developing nation, which is a PIE solely because the nature of its operations.

The proposal to remove the current emergency exception may impact numerous small PIEs which would normally turn to auditors for assistance in an emergency situation. These situations may be rare, but they might occur, for example, in the case of a sudden illness or death of the individual responsible for the bookkeeping or taxation procedures in a client or if an individual leaves the company without prior notice. In these circumstances until a new person is hired and properly trained, a smaller PIE may turn to an auditor and expect them to help on a temporary basis. This would most likely be the case if such an emergency occurs close to urgent external reporting deadlines, which must be met otherwise penalties will be incurred.

Whilst we agree that removing the exceptions reduces the potential for misuse, we are not aware of any evidence suggesting that these have been used inappropriately. On balance, we would prefer retaining some flexibility in emergency exceptions to permit bookkeeping and taxation support for a short period of time, providing the firm introduces appropriate safeguards.

We agree that section 100.11 could be used in an emergency or an unusual circumstance, but consider that the extant wording may require refinement because it currently only refers to “unusual circumstances in which the application of a specific requirement of the Code would result in a *disproportionate outcome* or an outcome *that may not be in the public interest...*”. As noted above, there may be rare circumstances that the auditor of a small PIE is required to assist a client in providing some non-assurance services for a brief time period. Therefore, if the current provisions are removed, it would be beneficial if the Code could provide additional guidance to clarify certain issues, such as the nature of the assistance that could be delivered along with the time period, and that these factors would feature in the auditor’s decision to consult in an emergency situation.

In our opinion it is important to recognize the variety of bookkeeping and taxation services in order to determine whether there is a threat to independence that needs to be mitigated or removed if it is so large that it cannot be adequately mitigated. There is a significant difference between an audit firm providing a temporary bookkeeper and a long-term recurring arrangement to assist with bookkeeping. Similarly, providing short-term one off assistance in the preparation of a tax return is unlikely to impact auditor



independence in the same way as providing expert advice on the tax implications of a large complex transaction.

Management Responsibilities

2. *Does the change from “significant decisions” to “decisions” when referring to management responsibilities (paragraph 290.162) enhance the clarity of a management responsibility?*

The proposal to remove the word “significant” before decisions in regards to management responsibilities does improve the clarity of paragraph 290.162. It removes the subjective definition of “significant” and reinforces the fact that management is responsible for leading and directing the entity, including making all decisions in that respect.

SMPs can be involved in decisions that are important to their clients but which do not compromise their independence or professional skepticism as auditors, as the decision-making itself remains with management. One example could be a technical evaluation for a potential new employee of a client, as some SMEs may not have internal technical experts to conduct such analysis. We therefore note and welcome the inclusion of the additional sentence in paragraph 290.164, which states that “providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility”. We believe this clarity is particularly helpful and would be appropriate to cover the example highlighted.

3. *Are the examples of management responsibilities in paragraph 290.163 appropriate?*

We recognize the intent behind including the examples of management responsibilities in paragraph 290.163. However, we are concerned that expanding the section is likely to directly impact SMEs and their SMPs as the examples are often considered grey areas and therefore do require careful consideration. In the SME environment the audit firm can be asked to support the client in unusual ways. This may involve being asked to keep safe custody of certain permanent records or minute books, to assist with the preparation of particular board motions, or for their opinion on policy development. This does not mean that the auditor is assuming management responsibility, merely that they are lending their expertise in such matters to the client.

Overall, we would support a more principles based approach in determining management responsibilities rather than the proposed specific and rigid changes. In particular, we do not agree with the deletion of the first sentence in paragraph 290.163 because the examples of activities considered to be management responsibility are meant to be just that – examples. The determination of what other activities may be considered management responsibility will require the auditor’s professional judgment and will depend on the circumstances.

We are concerned that the fifth bullet point “supervising activities for the purpose of management oversight” is unclear. If management performs the oversight using, for example, a report by the auditor on certain activities it could be questioned whether this constitutes supervision. The activities could be either an agreed-upon-procedures or a forensic audit engagement or may even be similar to internal audit services. We would assume that if the auditor is actually carrying out management oversight itself this would actually constitute taking on the management role. We would encourage the IESBA to clarify this point.



We are also concerned that the inclusion of the new word “supervising” in the third bullet point could have a significant impact for SMPs and their SME clients – “Directing, *supervising* or taking responsibility for the actions of employees in relation to the employees’ work for the entity”. For example, there may be instances where it might be necessary for the auditor to ‘supervise’ the employees’ procedures and potentially avoid necessary last minute reprocessing and adjustments.

4. *Are there any challenges in understanding and applying the prerequisite set out in paragraph 290.165 for non-assurance services that should be considered?*

We recognize the intention for the changes to ensure that there is no risk of a self-review threat by the auditor and clarify that they are not to assume management responsibility. However, we believe that from an SMP/SME perspective, the requirement for management to take responsibility for all judgments and decisions and understand the non-assurance services being provided should be sufficient and the new level of detail in paragraph 290.165 is overly prescriptive. It may also be interpreted as management having to delegate responsibility, and so weaken its decision making process. For example, in larger entities where the skill sets lie with junior staff not authorized to make management decisions. In our view this section could be simplified, whilst keeping the main messages clear.

It may also be particularly challenging for some SMEs that lack in-house experts possessing the required “suitable skill, knowledge and experience” and understanding of the “objectives, nature and results of the services” at the decision-making level for the service to then be undertaken in accordance with 290.165. SMEs could be disproportionately impacted by these requirements due to having fewer staff and a need for access to expert services from outside the organization. The proposed changes may be difficult in practice as the auditor will have to communicate to a client that a lack of skill, knowledge and experience of the matter at decision-making level will preclude the auditor assisting the client in that particular service area. Such a contention may damage the relationship of trust between the auditor and the client and have significant unintended consequences as the client could be forced to seek the service elsewhere. This could result in services being provided at lower quality and a higher cost as synergies due to audit knowledge are lost. In our view, this would neither be desirable nor in the public interest.

5. *Will the enhanced guidance assist engagement teams to better meet the requirement of not assuming a management responsibility?*

In our opinion, the enhanced guidance will assist engagement teams to better meet the requirement of not assuming a management responsibility.

6. *Does the relocation of the guidance pertaining to administrative services into its own subsection provide greater clarity?*

We support the relocation of the paragraph 290.166 to its own section.

It is not clear whether the examples intend to cover company secretarial services. The example of preparing statutory forms for client approval seems to indicate it does, but it may be more understandable if this could be specifically provided as an example. This is one area for which it would be helpful to clarify the Code for SMPs.



Revised paragraph 290.166 states that “Providing such services does not *generally* create a threat to independence”. We have difficulty envisaging circumstances when administrative services might threaten auditor independence and believe that auditors and audit oversight authorities may be unsure how to deal with this section as the inclusion of the word “generally” implies that this is not always the case. We therefore suggest examples be provided as to when the IESBA envisages a threat could arise, or the word “generally” be deleted.

Routine or Mechanical

7. *Does the proposed guidance on “routine or mechanical” clarify the term or is additional guidance needed?*

In the section on audit clients that are not PIEs (290.171), we understand that one of the reasons additional examples of services which are considered routine or mechanical in nature have been included is because they would be helpful to SMPs. However, we are concerned that these may actually create more ambiguity and would encourage the Board to exercise care in compiling the list of examples.

The fourth bullet point on calculating depreciation on fixed assets could be seen as a very good example of when a client would look to an auditor for advice and guidance on the appropriate treatment. This may include discussing the meaning of an assets useful life and residual value. As this should also be considered routine, we would recommend that this is clarified and the current wording slightly amended as this currently just focuses on “when the client provides” the accounting policy and estimates of useful life and residual values. The use of the word “determines” may be more appropriate as this would allow for the auditor to give advice in the process without making the decision.

The sixth bullet point in paragraph 290.171 allows for a firm to prepare financial statements based on information in the client-approved trial balance. For many SMP clients, obtaining a client-approved trial balance is not likely to be a significant obstacle. However, by definition, the financial statements also include required disclosures and a significant amount of information disclosed includes information that is not contained within a trial balance. We therefore consider it would in the best interest of practitioners for the IESBA to also address the impact of required disclosures in conjunction with the preparation of financial statements.

We note that some SMEs can require assistance on determining the appropriate account classification due to specific accounting rules. In addition, this example in the second bullet point raises a question on whether more guidance should be provided on how the determination or approval by a client should be formalized.

8. *Is the meaning and identification of source documents sufficiently clear, taking into account documents that may be generated by software?*

In our view the meaning and identification of source documents is clear, but could be improved by stating “original documents” or “original or source documents” instead of just “source documents”. We also note that many clients are now using cloud based accounting software where transactions are automatically downloaded from banks and auto posted to the general ledger. In many cases there is not a clear paper trail due to payment by bank transfers or other electronic means. In these cases the traditional concept of source documents becomes ambiguous.



Section 291

9. *Do the changes proposed to Section 291, specifically the additional requirements to proposed paragraph 291.146 enhance the clarity of a management responsibility?*

We refer to our comments in response to question 4, which also apply to proposed paragraph 291.164.

10. *Are the examples of management responsibilities in paragraph 291.144 appropriate?*

We refer to our comments in response to question 3, which also apply to proposed paragraph 291.144.

11. *Does the relocation of the guidance pertaining to administrative services provide greater clarity?*

We refer to our comments in response to question 6, which also apply to proposed paragraph 291.150.

CONCLUDING COMMENTS

We hope the IESBA finds this letter helpful in further developing its proposals to change certain provisions of the Code addressing non-assurance services for audit clients. In turn, we are committed to helping the Board in whatever way we can to build upon the results of this ED. We look forward to strengthening the dialogue between us.

Please do not hesitate to contact me should you wish to discuss any matters raised in this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Giancarlo Attolini', is written over a horizontal line. The signature is cursive and somewhat stylized.

Giancarlo Attolini
Chair, SMP Committee