Benchmarking Initiative

Laura Friedrich, Working Group Chair

IESBA Meeting (Virtual)
March 15, 2021
Objectives of Session

- To receive a recap/update on the WG's activities
- To discuss and agree on
  - The anticipated timeline/schedule
  - The outline and format of anticipated deliverables/reports
- To receive an overview of proposed terminology
Working Group

Members:
• Laura Friedrich, Working Group Chair
• Richard Huesken, IESBA Member
• Richard Fleck, Non-Assurance Services Task Force Chair

Staff:
• Szilvia Sramko, IESBA Manager – Project Lead
• Diane Jules, IESBA Deputy Director – Oversight

3 virtual meetings since January 2021
Recap from July 2020 Session

- Concerns that the IESBA Code’s conceptual framework approach allows firms too much flexibility and judgment
  - Benchmarking is a strategic exercise to promote awareness of International Independence Standards (IIS)
- Phase 1 will focus on comparing the IIS that are relevant to audits of PIEs to the US SEC/PCAOB independence rules
  - Focus will be on Part 4A, but given the Code's building-blocks architecture will include relevant provisions from Parts 1 and 3
Recap from July 2020

Objective of the Benchmarking Initiative

• Evaluation to focus on determining “equivalence in effect” which means assessing whether the two sets of standards:
  ➢ Apply to the same type of entity(ies)
  ➢ Apply to the same circumstances/services
  ➢ Achieve the same effect

→ thereby highlighting the similarities and differences between the IIS and the SEC/ PCAOB rules
→ No intention to make a judgment regarding which set of independence standards/ rules is more stringent overall
Anticipated Timeline

2021 March
- Mapping demo

2021 June
- Overview of key differences

2021 Sept
- Draft Mapping tables (incorporating NAS and Fees)
- Draft reports

2021 Oct/Nov
Publication of Final Documents
Areas of Focus (1)

• The mapping and analysis will first focus on IIS sections that have not been recently revised, so that WG can:
  ➢ Test the methodology on areas that are already well established
  ➢ Familiarize stakeholders with the approach and format of anticipated deliverables
• Revised provisions of Fees and NAS sections will be subject to analysis after their late April release
Areas of Focus (2)

- WG recognizes stakeholders’ particular interest in observations/ conclusions about the revised NAS provisions
  - The Benchmarking WG can coordinate with the NAS and Fees Rollout WG regarding the questions raised in relation to difference/equivalence of the revised NAS provisions
- Full analysis will be ready as part of the final Benchmarking reports
  - Such reports will include comparison of overarching approaches (i.e., General Standard and Code’s Conceptual Framework) and definitions/ descriptions of key terms and concepts, thereby providing sufficient context for the WG observations/conclusions
Matters for Consideration

- Do IESBA members have any comments regarding
  - The timeline of the Initiative?
  - The proposed timing of the analysis of sections (particularly the revised Fees/NAS sections)?
Reports Arising from the Initiative

• Final deliverables will include two reports:

  1. **Summary Report**: Summarizing at a high-level the approach taken and key findings
     - Not to exceed 10 pages; will target a broader stakeholder audience (e.g., regulators and policy makers); will refer to the additional information in the Detailed Report

  2. **Detailed Report**: Built around mapping tables including detailed comparisons of relevant IIS sections and the SEC/PCAOB rules; will highlight the key topics/ issues that are of interest to users
     - Will include an *Introductory Section* explaining the WG’s observations and conclusions about how the Code’s [Conceptual Framework to Independence](#) and the SEC/PCAOB General Standard compare
Reports Arising from the Initiative

Outline of the Summary Report

• The Summary Report will include:

1. Introduction and context - explaining the need for the project
2. Methodology of the benchmarking - overall approach taken and key uncertainties faced (such as timing of changes)
4. Overall findings – (i) both the IIS and the SEC/PCAOB’s rules reflect hybrid approaches with general principles and topic-specific requirements (ii) approach to main areas that are "equivalent in effect"
5. Summary of noteworthy differences – provisions that are not "equivalent in effect"
6. Future-looking notes – possible areas for the Board’s consideration
The IIS and the SEC/PCAOB rules both include strong overarching principles that are supported with specific requirements (where certain actions, services or activities are prohibited)

- Comparison of the Code’s Conceptual Framework and the SEC/PCAOB’s General Standard is important to the benchmarking exercise
  - WG believes that detailed Mapping Tables should be read in conjunction with the introductory section to the detailed report
  - Introductory section will also provide relevant context about how users of the document should read the Mapping Tables and the WG’s conclusions
Reports Arising from the Initiative

Detailed Report - Methodology Used in Mapping Tables

• WG has tested the “paragraph-by-paragraph” methodology on sample IIS sections
  ➢ The resulting initial mapping tables were too detailed → would not be user friendly

• WG is proposing a new methodology
  ➢ WG will prepare detailed analysis and conclusions involving all Requirements and Application material in IIS and the corresponding SEC/PCAOB rules
    → However, the published report will focus on specific services/relationships and whether they are prohibited by the Code and/or the SEC requirements, framed as ‘issues of interest’ to users
    → Mapping tables will be used to present comparisons and WG’s conclusions regarding equivalence in effect

• The detailed report and its analysis will be published as an IESBA Staff document
Reports Arising from the Initiative

WG’s Current Thinking re Mapping Tables

<table>
<thead>
<tr>
<th>Issues</th>
<th>Per Code</th>
<th>Per SEC</th>
<th>IESBA Code’s Provisions</th>
<th>SEC/PCAOB Rules</th>
<th>Comments</th>
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</thead>
<tbody>
<tr>
<td>Financial Interest Held by the Firm, a Network Firm, Audit Team Members and Other Individuals</td>
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<tr>
<td>Direct or material indirect financial interest held by the firm, network firm, audit team members or other relevant partners.</td>
<td>Prohibited</td>
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<tr>
<td><strong>RS10.4</strong> Subject to paragraph RS10.5, a direct financial interest or a material indirect financial interest in the audit client shall not be held by: **</td>
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<td>a. The firm or a network firm;</td>
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<td>b. An audit team member, or any of that individual’s immediate family;</td>
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<td>c. Any other partner in the office in which an engagement partner practices in connection with the audit engagement, or any of that other partner’s immediate family; or</td>
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<td>d. Any other partner or managerial employee who provides non-audit services to the audit client, except for any whose involvement is minimal, or any of that individual’s immediate family.</td>
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<td>2-01 (c) (1) (i) Investments in audit clients: An accountant is not independent when: **</td>
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<td>(A) The accounting firm, any covered person in the firm, or any of his or her immediate family members, has any direct investment in an audit client, such as stocks, bonds, notes, options, or other securities. **</td>
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<td>(B) The accounting firm, any covered person in the firm, any of his or her immediate family members, or any group of the above persons has any material indirect investment in an audit client.</td>
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<td>Equivalent in effect **</td>
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<td>SEC and IESBA each have explicit prohibitions on holding direct or material indirect financial investment in the audit client by the accounting firm, network firms, audit team members and their immediate family. **</td>
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<td>Note: The SEC rules and the Code both include exceptions that permit the temporary holding of financial interests obtained by immediate family through employment rights. See RS10.5 and 2-01 (c)(1)(iii)(C). **</td>
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This example is provided for illustrative purposes only. It does not reflect the WG’s final conclusions.

Issue of interest (e.g., whether a particular service / relationship is prohibited or permissible)

WG’s response

Relevant provisions and rules

WG’s conclusion and key notes to readers
Matters for Consideration

• Do IESBA members have any comments regarding the
  - format and outline of the final reports (Summary and Detailed)?
  - presentation approach suggested for the Detailed Report mapping tables?
WG’s Current Thinking About Views Expressed in Reports

• Mapping tables should use consistent terminology for WG’s conclusions regarding equivalence or difference in the comparison
  – This will enhance users’ understanding regarding the WG’s conclusions

• Regarding the extent of equivalence or difference, WG has considered some potential outcomes
Mapping table will focus on whether the provisions are "equivalent in effect"?

Provisions can be "equivalent in effect" in the following ways:

1. Both IIS and SEC/PCAOB have specific requirements, and the requirements are "equivalent in effect"

2. Only one has a specific requirement, but through the application of the CF/General Standard, the independence frameworks are "equivalent in effect" regarding the specific matter
1. Both IIS and SEC/PCAOB have requirements, and the requirements are equivalent in effect.

<table>
<thead>
<tr>
<th>Issue of interest</th>
<th>Relevant provisions and rules</th>
<th>WG’s conclusion</th>
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</table>
| **WG’s Current Thinking**

**Terminology Used for Equivalence – Examples (1)**

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<td>RS10.4 Subject to paragraph RS10.5, a direct financial interest or a material indirect financial interest in the audit client shall not be held by: a. The firm or a network firm; b. An audit team member, or any of that individual’s immediate family; c. Any other partner in the office in which an engagement partner practices in connection with the audit engagement, or any of that other partner’s immediate family; or d. Any other partner or managerial employee who provides non-audit services to the audit client, except for any whose involvement is minimal, or any of that individual’s immediate family.</td>
<td>Equivalent in effect</td>
<td>SEC and IESBA each have explicit prohibitions on holding direct or material indirect financial investment in the audit client by the accounting firm, network firms, audit team members and their immediate family. Note: The SEC rules and the Code both include exceptions that permit the temporary holding of financial interests obtained by immediate family through employment rights. See RS10.5 and 2-01 (c)(1)(iii)(C).</td>
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Only one has a requirement, but through the application of the CF/General Standard the independence frameworks are equivalent in effect regarding the specific matters.

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<td>Financial interest held by the Audit Client in the Accounting Firm</td>
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<td></td>
<td>2-01 (c) (J) (A) An accountant is not independent when: Investments by the audit client in the accounting firm. An audit client has, or has agreed to acquire, any direct investment in the accounting firm, such as stocks, bonds, notes, options, or other securities, or the audit client’s officers or directors are record or beneficial owners of more than 5% of the equity securities of the accounting firm.</td>
</tr>
<tr>
<td>Audit services provided to an entity that holds an investment in the firm.</td>
<td>Prohibited</td>
<td>Prohibited</td>
<td>Application of the CF: An audit client holding a direct investment in the firm would give rise to a familiarity or intimidation threat, that could not be mitigated through safeguards. Application of the CF would result in the conclusion to withdraw from the engagement or for the client to dispose of the interest.</td>
<td>Equivalent in effect, through application of CF.</td>
</tr>
</tbody>
</table>

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**Terminology Used for Differences**

- Provisions are "not equivalent in effect", if:
  1. Both IIS and SEC/PCAOB have requirements, but the requirements are “not equivalent in effect”
  2. Only one has a requirement and even through the application of the CF/General Standard, the independence frameworks are not equivalent in effect regarding the specific matter

  ➢ WG will aim to apply consistent terminology, but flexibility might be needed on a "case-by-case" basis
Matters for Consideration

- Do IESBA members have any comments regarding the
  - Proposed terminology used for the WG’s conclusions in the mapping tables?
Do IESBA members have any suggestions regarding specific areas of comparison that might be particularly informative?