

Non-audit Services

Background

At the last IESBA meeting, the Board asked the Task Force to “bench mark” the position taken in the Code with respect to the provision of non-audit services and to consider whether the Code should include any other examples of non-audit services. The purpose of this paper is to summarize the Task Force’s work to date and its conclusions.

Discussion

A high-level review was performed of the standards related to non-audit services promulgated by the SEC/PCAOB, APB and AICPA. In addition, the Task Force considered the European Commission’s Recommendation of 16 May 2002, *Statutory Auditor’s Independence in the EU: A Set of Fundamental Principles*. The Appendix to this paper contains a comparison of the non-audit services covered by such standards. As noted, this review was not undertaken with the objective of fine-tuning the language in the IFAC Code with respect to any particular service; rather, the Task Force focused on the category of service and whether such category should be added to the IFAC Code.

The Task Force also reviewed the existing examples included in the Code to determine whether changes should be recommended to the Board. This process is still underway and the Task Force needs to complete its benchmarking efforts.

This paper presents tentative conclusions of the Task Force to-date. As the Task Force completes the benchmarking exercise there may be further recommendations.

Conclusions

The Task Force concluded that coverage in the existing Code of the examples of non-audit services was generally appropriate. However, because the Code does not specifically cover actuarial services, the Task Force is of the view that the valuation section should be modified to also cover actuarial services. The Task Force considered the following non-audit services and concluded that they sufficiently addressed using the general threats and safeguards approach.

- Payroll services
- Benefit Plan Administration
- Translation services

The Task Force recognized that transaction-related services are quite common and often represent a sizable portion of a firm’s business. The Task Force has therefore developed a separate position paper on this issue. Please see Agenda Paper 3-J.

With respect to the non-audit services already covered in the Code, the Task Force reached the following tentative conclusions:

- *Bookkeeping services* – see Agenda Paper 3-G

- *Valuation services* – the language “to be incorporated in the financial statements” should be clarified as it is unclear exactly what is covered by this. The Task Force recommends something along the lines of “valuation that will be used to determine whether the financial statements are fairly presented.” Also, the Code should be clear that the firm can advise management of the appropriate valuation methods, assumptions etc. The Task Force, based on a recommendation of the CAG, will also propose wording to explain what is meant by “significant subjectivity.”
- *Taxation services* – to be discussed in a separate agenda paper to be tabled at June IESBA meeting.
- *Internal audit* – the Code seems to be out of step in this area with others. A position paper will be prepared to address this issue in more detail. The Task Force will also consider any implications of the new requirements of ISA 315, which requires the auditor to obtain an understanding of the entity and its environment including internal controls (which includes internal audit).
- *IT services* – the provisions in the Code on IT services should distinguish between non-listed and listed audit clients, similar to the distinction in the area of bookkeeping services. The rationale for this change is that the principle threat is self-review and is not unlike the threat that exists in the case of bookkeeping services. Thus, for listed financial statement audit clients, design *or* implementation of financial information reporting systems would be prohibited unless the system is immaterial to the financial statements. For non-listed audit clients, the firm should only design *or* implement IT systems if the safeguards in ¶290.188 are applied. The Task Force recommends that an exemption for recommending or installing pre-packaged software be included.
- *Temporary staff assignment* – these engagements seem to relate to employment and therefore, a new section should be created, which would follow employment and would be entitled “Temporary Assignment to Assurance Clients. In addition, the Task Force concluded that the guidance should include the following:
 - Temporary means of a limited basis and short in duration, otherwise there may be too great a familiarity threat
 - Cannot perform a service that would otherwise be prohibited or create an unacceptable threat to independence
 - If the temporary staff assignment relates to the financial statements, then the individual cannot be on the audit team
 - Safeguards should be applied to reduce the threat to an acceptable level.
- *Litigation support* – some discussion should be added about estimation of damages and if such amount is material to the financial statements and involves a significant degree of subjectivity, the firm should not perform the service. This would be in line with the provisions on valuation services. Moreover, a reference to advocacy threat when providing expert services should be added to this

example. Finally, the Task Force proposes deleting paragraph 290.195 as being unnecessary.

- *Legal services* – significant changes are not required; however, the language needs some editing.
- *Recruiting senior management* – in the case of listed financial statement audit clients, the firm should not recruit individuals who can exert significant influence over the financial statements.
- *Corporate Finance* – this discussion should be limited to financial statement audit clients.

Action requested

Members are asked to consider and provide feedback on the tentative conclusions of the Task Force.

Provision of Non-assurance services

The Task Force also noted that the section which addresses the provision of these services is titled “Provision of non-assurance Services to Assurance Clients”. The Task Force is of the view that it would be more appropriate to title the section “Provision of non-audit Services to Assurance Clients”. The Task Force is of the view that without such a change, paragraphs 290.158-205 could be read as applying only to non-assurance services, which would mean, for example, if a valuation service was structured as an assurance service, it would not be covered by the guidance in 290.174-179.

Action requested

Members are asked to consider the Task Force recommendation that the section should refer to the provision of non-audit services as opposed to non-assurance services.

Not subject to audit procedures

The U.S. SEC included in its 2003 rules an exception to the rules that certain services impair the auditor’s independence. Specifically, the provision of bookkeeping services, valuation reports, internal audit outsourcing, actuarial services and financial information design and implementation will not impair independence provided it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the audit client’s financial statements. Subsequently, the SEC staff issued FAQs that included an interpretation of this exception. The staff concluded that this exception does not apply downstream, stating as follows:

“There is a rebuttable presumption that the prohibited services will be subject to audit procedures. Determining whether a subsidiary, division, or other unit of the consolidated entity is material is a matter of audit judgment. Thus, the determination of whether to apply detailed audit procedures to a unit of the consolidated entity is, in and of itself, an audit procedure. Therefore, materiality is not an appropriate basis upon which to overcome the presumption in making a determination that it is reasonable to conclude that the results of the services will not be subject to audit procedures.”

Moreover, the SEC staff has informally indicated that the exception would not apply downstream even if the subsidiary were audited by another auditor. Consequently, the exception only applies where the auditor does not audit the SEC registrant but is required to be independent of the registrant or commonly controlled entities.

Although the SEC does not explain the exception using “threats and safeguards” language, it seems apparent that this exception is based on the fact that the self-review threat to independence that is common to these 5 services would not be present if the results of the service would not be subject to audit procedures. Where the threat is something other than self-review, the exception does not apply. Thus, for example, the provision prohibiting legal services does not include any exception because some believe that legal services typically involve an advocacy threat.

The Task Force has discussed this concept and is of the view that it would be useful to include the concept in Section 290. It has not yet debated how the concept will be incorporated – for example as an overall consideration when assessing a threat to independence consideration is given to whether the results of the work will be subject to auditing procedures; or whether it should be incorporated into the guidance for particular types of non-audit services.

Action requested

Members are asked to consider whether they agree that Section 290 should include the concept of whether the results of performing a non-audit service will be subject to auditing procedures.

Appendix

NON-AUDIT SERVICES COVERED IN VARIOUS INDEPENDENCE RULES

	<u>IFAC</u>	<u>EU*</u>	<u>SEC/ PCAOB</u>	<u>APB</u>	<u>AICPA</u>
1. Preparing Accounting Records and Financial Statements					
a. Preparing accounting records	√	√	√	√	√
b. Preparing financial statements	√	√	√	√	√
c. Determining/changing journal entries etc.	√	√	√	√	√
d. Authorizing/approving transactions	√	√	√	√	√
e. Preparing source documents or originating data	√	√	√	√	√
f. Accounting and bookkeeping services of a routine nature	√	√	√	√	√
g. Emergency situations	√	√		√	
h. Immaterial subsidiaries	√	√	√	√	
2. Valuation Services					
a. Valuations effecting the financial statements	√	√	√	√	√
b. Valuations for non-financial reporting purpose			√		
c. Valuations for tax purposes	√		√		√
d. Fairness opinions			√		
e. Contribution-in-kind reports			√		
f. Valuations where auditors designated by legislation or regulations				√	
3. Taxation Services					
a. General provision covering all services	√		√	√	
b. Aggressive tax advice			√	√	
c. Tax services to certain executives			√		
d. Representing clients before tax courts	√		√	√	
4. Internal Audit Services					
a. Outsourcing of internal audit activities	√	√	√	√	√
b. Nonrecurring evaluations of discrete items			√	√	√
c. Operational internal audits			√	√	√
5. IT Systems Services					
a. Design and implementation of financial information technology systems	√	√	√	√	√
b. Install off-the-shelf software				√	√
c. Assessment, design and implementation of internal accounting and risk management controls	√	√	√		
d. Operating the client's system or managing the client's LAN			√		√

	<u>IFAC</u>	<u>EU*</u>	<u>SEC/ PCAOB</u>	<u>APB</u>	<u>AICPA</u>
6. Temporary Staff Assignments					
a. Lending of staff	√				
7. Litigation Support Services					
a. Expert witness	√		√	√	
b. Calculating estimated damages	√			√	
c. Document management	√			√	
8. Legal Services					
a. Legal advisory services	√		√	√	
b. Litigation	√	√	√	√	
9. Recruiting Senior Management					
a. Recruiting	√	√	√	√	√
b. Engaging in testing and evaluation programs			√		
c. Undertaking reference checks			√		
d. Acting as a negotiator on client's behalf			√		√
e. Recommending specific candidates			√		√
f. Taking responsibility for appointment of a director or employee or advice on remuneration package				√	√
10. Corporate Finance and Similar Activities					
a. Corporate finance services	√		√	√	√
b. Promoting, dealing in or underwriting	√		√	√	√
c. Making investment decisions for the client					√
d. Having discretionary authority over the client's investments			√		√
e. Having custody of the client's assets			√		√
f. Other investment advisory services					√
11. Actuarial Services					
a. Actuarially-oriented advisory services			√		√
b. Actuarial valuation services			√	√	√
12. Management Functions					
a. Acting in a management capacity	√	√	√	√	√
b. Designing and implementing internal accounting and risk management controls			√		√
13. Expert Services					
a. Providing expert opinion in a regulatory or administrative proceeding or investigation			√		
14. Transaction Related Services					
a. Due diligence and other services related to transactions				√	

	<u>IFAC</u>	<u>EU*</u>	<u>SEC/ PCAOB</u>	<u>APB</u>	<u>AICPA</u>
15. Payroll and Other Disbursements					
a. Various examples of permissible and prohibited services					√
16. Benefit Plan Administration					
a. Various examples of permissible and prohibited services					√

*Source: Commission Recommendation of 16 May 2002, Statutory Auditors' Independence
in the EU: A Set of Fundamental Principles