

PROJECT PROPOSAL—NON-ASSURANCE SERVICES**I. Subject**

1. The non-assurance services provisions in Sections 290 and 291 of the Code dealing with independence.

II. Background and Relevant Developments**INDEPENDENCE I**

2. In the early part of the prior decade, several major corporate failures led to a loss of credibility in aspects of the financial reporting process and prompted many jurisdictions to take steps to restore credibility. Some of these steps related to independence requirements for accountants performing assurance engagements. In the light of these developments, the IESBA decided to commence a project to determine whether to revise any of the independence requirements contained in Section 290 of the Code and which dated from 2001 (Independence I project).
3. In December 2006, the IESBA issued an exposure draft (ED) of proposed changes to the independence requirements contained in the Code, including:
 - Updating requirements related to the provision of non-assurance services, including setting out additional guidance on the provision of tax services to audit clients; and
 - Splitting the existing Section 290 into two sections: a proposed revised Section 290 setting out independence requirements for audit and review engagements, and a proposed new Section 291 setting out independence requirements for other assurance engagements.
4. The completion of this project in January 2008 led to a number of significant changes to the Code. With respect to the provision of non-assurance services, these changes included updated requirements related to, in particular:
 - Valuation services for public interest audit clients;
 - Tax services;
 - IT systems services; and
 - Corporate finance services.

INDEPENDENCE II

5. The December 2006 ED under the Independence I project indicated that there were three additional areas that would be addressed by the IESBA. In July 2007, the IESBA issued an ED (Independence II project) addressing these areas:
 - Provision of internal audit services to an audit client;
 - Relative size of fees from an audit client that is an entity of significant public interest; and
 - Additional guidance with respect to providing services to an assurance client on a contingent fee basis.

6. In May 2008, the IESBA issued a re-exposure draft of its proposals relating to internal audit services and the relative size of fees. It also proposed additional guidance with respect to providing services to an assurance client on a contingent fee basis. The IESBA approved the final changes to the independence requirements contained in the Code in December 2008.
7. The changes to the Code resulting from the two independence projects (Independence I and II) were released in July 2009 at the same time as changes arising from the IESBA's project addressing the redrafting of the Code based on new drafting conventions.

INTERNATIONAL DEVELOPMENTS

8. Although the independence requirements were modified in 2009, that year also marked the advent of the global financial crisis. As a result of the crisis, a number of major jurisdictions around the world have initiated, or been actively engaged in, policy debates regarding ways to enhance audit quality. Among several policy initiatives that are currently actively being pursued in these jurisdictions are proposed changes to national requirements relating to the provision of non-audit services.
9. Highlights of these significant developments are set out below.

Developments in the US

10. In August 2011, the US Public Company Accounting Oversight Board (PCAOB) issued its Concept Release, *Auditor Independence and Audit Firm Rotation*, exploring ways that auditor independence, objectivity and professional skepticism could be enhanced. Among other matters, the release:
 - Explores the possibility of mandatory firm-rotation in detail;
 - Considers whether an auditor's judgment may be affected by an economic interest in a non-audit relationship; and
 - Considers the impact on independence of limitations on the kinds of non-audit services a firm may provide to an audit client.
11. This initiative is currently in progress.

Developments in the European Union

12. In November 2011, the European Commission (EC) issued a set of legislative proposals aimed at addressing issues pertaining to the role of the auditor, auditor independence and the structure of the audit market in Europe. In addition to requirements for tendering, audit-only firms and mandatory audit firm rotation after six years (with certain exceptions),¹ the proposals include significant restrictions relating to the provision of non-audit services.
13. With respect to non-audit services specifically, the EC proposals would prohibit the provision of most non-audit services to public interest entity (PIE) audit clients, including almost all tax services. In certain limited circumstances, however, a firm would be permitted to provide a very narrow category of services referred to as "related financial audit services," with the fees for such services

¹ The IESBA considered the topics of tendering and mandatory audit firm rotation at its June 2012 meeting as part of a broader discussion on strengthening safeguards against familiarity threats.

limited to 10% of the audit fees. A firm would be permitted to provide certain other non-audit services to a PIE client, but only with pre-approval by the audit committee, or the regulator, as specified. These proposals are under extensive and continuing review in Europe, including by Member State Parliaments, and a conclusion is expected in 2013.

Developments in Canada

14. In September 2012, the Canadian Institute of Chartered Accountants (CICA) and the Canadian Public Accountability Board (CPAB) jointly issued a Discussion Paper (DP), *Enhancing Audit Quality: Canadian Perspectives – Auditor Independence*. The DP analyzes ways in which audit quality could be enhanced by addressing the independence of the auditor, the role of audit committees and auditor reporting, including whether there should be additional prohibitions on non-audit services in the Canadian context.
15. With respect to non-audit services in particular, the DP expresses support for additional prohibitions regarding:
 - The provision of personal tax services for individuals in a financial reporting oversight role; and
 - The provision of services related to advice on aggressive and confidential tax transactions.

It also recommends further study on the question of non-audit services being performed on a contingency fee basis to assess the impact on auditor independence.

IESBA 2008-2009 STRATEGY PROPOSALS

16. In July 2007, the IESBA published its consultation paper *Strategic and Operating Plan, 2008-2009*. Among the various responses was a recommendation from the International Organization of Securities Commissions (IOSCO) for the IESBA to make use of IOSCO's significant study on the regulation of non-audit services undertaken in 2006 and 2007 to identify which audit services are prohibited in practice, and why (see Appendix A). The comment letter emphasized the need for the IESBA to work towards greater convergence in this area.
17. The Basis for Conclusions document for the final strategy and work plan acknowledged the comment from IOSCO and indicated that the IESBA would use the survey in discussion at four regional forums or roundtables as well as at the IESBA-National Standard Setters (NSS) meeting to facilitate discussion on convergence. The 2008-2009 strategy and work plan, however, did not include a commitment by the IESBA to undertake a specific project on non-assurance services.

IESBA 2010-2012 STRATEGY PROPOSALS

18. In March 2010, the IESBA published its consultation paper *Strategy and Work Plan, 2010-2012*. Among the various responses was again a recommendation from IOSCO for the IESBA to revisit as a matter of priority the Code's requirements related to the provision of non-assurance services (see Appendix A).
19. The final Strategy and Work Plan document signaled that, as part of its convergence activities, the IESBA would initiate in early 2011 a comparison of key independence provisions of the Code for audits of PIEs to the standards and regulations of select jurisdictions, and determine whether action should be taken to reduce or eliminate the differences and what that action should be.

BENCHMARKING EXERCISE

20. Pursuant to the commitment in the 2010-2012 strategy, the IESBA undertook a benchmarking exercise comparing the independence requirements set out in Section 290 of the Code with the requirements in Australia, Brazil, France, Germany, Japan, Hong Kong, UK and the US.
21. The findings were considered at the June 2011 IESBA meeting.² It was noted that at the April 2011 IESBA-NSS meeting, a key message had been the importance of respecting national sovereignty. In this regard, participants at that meeting had observed that the objective of a single global independence standard might never be achievable, and perhaps the only achievable objective would be use of the independence requirements contained in the Code by foreign auditors of foreign subsidiaries. The IESBA nevertheless agreed that the Planning Committee should develop a proposal to review the Code's requirements relating to the provision of non-assurance services for its consideration in due course.

NEW NON-ASSURANCE SERVICES WORK STREAM

22. Given the international developments outlined above in the context of the recent financial crisis, the IESBA initiated a discussion at its February 2012 meeting regarding whether the Code should include additional restrictions on auditors providing non-assurance services. The discussion took into account possible measures being debated in a number of major jurisdictions, including Europe and the US, to strengthen auditor independence. The minutes of the meeting noted the following:

Feedback from certain of the Board's constituents suggests that prohibitions based on materiality pose challenges because of its subjective nature and the Code's lack of guidance on how to evaluate materiality. The IESBA agreed that it should develop a position on the significant matters, [including] whether further restrictions on non-assurance services are needed, that are within the Board's purview and under consideration in Europe, the US, and other key jurisdictions.

23. As a result of the discussion, in May 2012 the IESBA added an additional work stream to its 2010-2012 strategy as follows:

The IESBA will consider whether the Code should include additional restrictions on auditors providing non-assurance services to their audit clients and whether the use of materiality as the basis for prohibiting certain non-assurance services remains appropriate. If materiality continues to be appropriate, the IESBA will consider whether the Code should contain guidance for applying it. If certain non-assurance services will continue to be permitted, the IESBA might also consider whether they should be subject to pre-approval by those charged with governance, restricted in size in relation to the audit fee, or publicly disclosed. The IESBA expects to begin discussions in the last quarter of 2012.

² The benchmarking exercise was undertaken by a number of IESBA members and technical advisors on a best efforts basis. The results from that exercise had not been validated by any relevant regulators or IFAC member bodies.

III. Project Objectives, Scope, Focus and How They Serve the Public Interest

Project Objective

24. The objective of this project is to review the non-assurance services provisions in the Code to ensure that they continue to support a rigorous approach to independence for assurance services, particularly audits of financial statements.

Project Scope

25. As a matter of priority, the project scope will encompass in whole, or in part, the provisions in the subsection *Provision of Non-assurance Services to Audit Clients* (paragraphs 156-219) of Section 290 of the Code.
26. Of lesser priority will be the provisions in the subsection *Provision of Non-assurance Services to Assurance Clients* (paragraphs 143-150) of Section 291 of the Code. (See further discussion regarding the approach to the project under Development Process below.)

Focus of the Project

27. The project will focus in the following main areas, with priority consideration given to Section 290 of the Code:
- (a) Reviewing the non-assurance services provisions in the Code and evaluating whether the existing prohibitions or permissions remain appropriate in the light of current requirements of major jurisdictions. Consideration will, in particular, be given to whether existing prohibitions should be maintained or eliminated, or whether further restrictions should be introduced;
 - (b) Considering other non-assurance services not explicitly addressed by the Code but addressed by other major jurisdictions to determine whether the Code should address such services;
 - (c) Whether materiality remains an appropriate basis for prohibitions with respect to certain non-audit services for an audit client or whether another basis might be more appropriate;
 - (d) Whether there should be approval by those charged with governance prior to the provision of specific, or all, non-assurance services, and in what circumstances;
 - (e) Whether there should be regulatory approval prior to the provision of non-assurance services, and, if so, for which non-assurance services and in what circumstances;
 - (f) Considering the merits and practical implications of introducing a “cap” on the extent to which a firm may provide non-assurance services, for instance, whether fees for non-audit services should not exceed a specific percentage of total audit fees for the client;
 - (g) Considering the need for further guidance addressing “contingent fee-based” non-assurance services;
 - (h) Assessing the extent to which convergence of the prohibitions on non-assurance services may be facilitated; and
 - (i) Considering the exemptions that should be provided, if any.

How the Project Serves the Public Interest

28. Varying views exist on the extent to which the provision of non-assurance services may impair independence. This project will further address the impact of the provision of non-assurance services on a professional accountant's ability to provide an objective opinion or conclusion on an entity's financial or other information in an assurance engagement, and to approach the engagement with appropriate professional skepticism. The project will, in particular, further support the IESBA's contribution to improving audit quality.

IV. Outline of the Project

Issues that Will Be Addressed

29. The Code currently includes a number of restrictions on the provision of non-assurance services. However, the comparable restrictions differ across jurisdictions. Based on the benchmarking exercise the IESBA conducted in 2011, it appears that US Securities and Exchange Commission (SEC) regulations and French requirements are generally more restrictive than the Code. Other jurisdictions also appear to have greater restrictions in a number of areas. In addition, the EC's November 2011 regulatory proposals appear stricter in several instances. These data points appear to suggest a need to reconsider the Code's provisions regarding non-assurance services to ensure that they continue to be appropriate in a Code for global application.
30. The Code currently addresses several key topics under the non-assurance services provisions of Section 290. The project will review each of these areas to consider key differences relative to national requirements in major jurisdictions, and related issues, including whether:
- "Management responsibilities" may also include routine or administrative items, and whether a firm should be explicitly prohibited from providing routine or administrative services (see Appendix B, paragraphs 1-2);
 - The Code should continue to permit, in certain limited circumstances, a firm to provide accounting and bookkeeping services, including payroll services and the preparation of financial information of a routine or mechanical nature to an audit client that is a PIE (see Appendix B, paragraphs 3-5);
 - To retain the Code's "emergency exception" that permits, with respect to an audit client that is a PIE, a firm to provide accounting and bookkeeping services, including payroll services and assistance with the preparation of financial statements and financial information (see Appendix B, paragraphs 3-5);
 - Valuation services expected to have an immaterial effect separately or in aggregate on the financial statements should be permitted (see Appendix B, paragraphs 6-8); and
 - Materiality remains an appropriate basis for prohibitions with respect to certain non-audit services for an audit client or whether another basis might be more appropriate, for example, size of non-audit fees relative to audit fees; alternatively, whether the concept of materiality can be clarified to address regulatory concerns regarding inconsistent application in practice.
31. Consideration will also be given to whether the Code's requirements related to other non-assurance services in Section 290 should be revised.

32. Equally, the project will give consideration to the continuing robustness of the non-assurance services provisions in Section 291, including any consequential revisions that may be necessary as a result of changes to the non-assurance services provisions in Section 290.

Impact Analysis Considerations

33. Should the non-assurance services provisions in the Code be further enhanced, the primary benefit would be to strengthen the independence of the professional accountant.
34. There would likely be implementation costs at the entity and firm levels from the introduction of further restrictions or prohibitions on the provision of non-assurance services. Entities, in particular, may need to devote additional resources to sourcing alternative providers for specific non-assurance services currently provided by their assurance providers, should such services be subject to new or further restrictions.
35. On the other hand, it is possible that the introduction of new or further restrictions leads to the development of greater competition among firms for some non-assurance services, a benefit for the assurance market as a whole.
36. As the project progresses, further consideration of costs and benefits will be an important part of the IESBA's evaluation of the project. IFAC is currently developing an impact analysis framework for the standard-setting bodies that it supports.

V. Implications for any Specific Persons or Groups

37. The project has particular implications for:
- National standard setters and IFAC member bodies that have adopted the Code, or used it as a basis or a benchmark for their own ethical standards;
 - Firms that are subject to the requirements of the Code or national ethics standards that are based on the Code; and
 - National regulators that use the Code's provisions as a benchmark or as a basis for the development of their independence rules pertaining to the provision of non-assurance services by firms to their clients.
38. This project may also have implications for the IAASB relative to the provisions in ISQC 1³ dealing with the communication of relevant information about client engagements within the firm, including the scope of services provided.
39. Depending on the nature of the proposals, there may be fewer implications for smaller practices that audit small and medium-sized entities. IFAC's Small and Medium Practices (SMP) Committee will be kept apprised of developments to ensure appropriate input is received at key stages of the project.

³ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

VI. Development Process, Project Timetable and Project Output

Development Process

40. It is anticipated that the project will follow the normal development process of the IESBA for changes to the Code.
41. Given the breadth of the subject area, the project Task Force may consider it appropriate to split the project into two separate phases in order to achieve an earlier delivery of an exposure draft with respect to the first phase. The project Task Force will determine what will be an appropriate scope for this first phase based on an assessment of areas within Section 290 that would merit priority consideration and seek the Board's concurrence thereon.
42. Consequential changes to Section 291 may be made as part of the first phase for consistency.
43. Because there are a number of ongoing initiatives in this area, the project approach will include appropriate dialogue with others actively working in this area so that, to the extent possible, consistent requirements and guidance are developed.
44. The project will also consider whether the benchmarking exercise undertaken in 2011 should be refreshed or expanded via surveys, consultation with NSS and regulators, or other means.
45. Finally, there is much academic research in this area which the project will explore.

Project Timetable

46. Subject to the IESBA's approval of the project proposal, this project will commence immediately. The specific project milestones and outputs will be dependent on the matters that the project Task Force ultimately determines are appropriate to address as part of the project, and the priorities assigned to those matters.
47. The table below provides indicative timing for the first phase only, assuming a phased approach were to be adopted.

Indicative Timing	Milestone
December 2012	Approval of project proposal
Q2 2014	Approval of exposure draft – Phase I
Ongoing	Dialogue with stakeholders on key issues and proposals ⁴

Project Output

48. The output of the project could be changes to the non-assurance services provisions in the Code or new provisions in that area.

⁴ To include discussion with the IESBA CAG and IESBA-NSS Liaison Group

VII. Resources Required

49. A project Task Force will be established, consisting of four individuals, including an IESBA member as Chair.
50. Consideration will also be given as to how to best obtain appropriate input from other stakeholders with similar projects (in particular, regulators). This may include extending an invitation for a representative from other organizations to serve as members of the project's Task Force, correspondent members, or by other means.
51. IESBA Staff will provide support to the project Task Force.

VIII. Relevant Sources of Information that Address the Matter Being Proposed

52. Relevant sources of information include:
 - Non-assurance services provisions in major jurisdictions around the world.
 - IOSCO *Survey on the Regulation of Non-audit Services Provided by Auditors to Audit Companies*, January 2007.
 - European Commission *Study on the Effects of the Implementation of the Acquis on Statutory Audits of Annual and Consolidated Accounts Including the Consequences on the Audit Market*, November 2011.
 - International networks of firms, with regard to their approaches to compliance with requirements related to the provision of non-assurance services across their networks.

Appendix A

Exposure Draft Comment Letter Excerpts

A. IOSCO Comments – Strategic and Operational Plan, 2008-2009

1. “We would like to see much more emphasis placed upon the matter of the IESBA providing leadership in working for progress toward global convergence in auditor independence and ethics standards. IOSCO carried out a significant study on regulation of non-audit services in 2006 and 2007, and we believe that the Board should make great use of this study as well as other studies made in various jurisdictions, to analyse and identify which non-audit services are prohibited in practice and why. We would like to emphasize that in making this statement, we make no presumptions about what kinds of changes might need to be proposed and adopted to move toward greater convergence, specifically whether a requirement on a given matter should be made more or less stringent in the Ethics Code. Rather, we would like to see the Board examine the nature of each present practice that differs among jurisdictions, its actual and potential effects on auditor behaviour and audit quality and on investor perceptions, and the costs and benefits involved, and consider all factors objectively in an effort to work for progress toward global convergence in independence requirements around the world.
2. We understand that the Board is trying to promote the global use of the IFAC Ethics Code in countries whose capital markets are in different stages of development, and in which legal frameworks vary widely. We recognize that working to reduce differences and especially conflicts in independence requirements is very challenging. But if such work is never begun, progress will never take place. We think the IESBA would be ideally positioned to undertake such projects in partnership with national standards setters in the context of working for convergence in professional standards and those projects such as this would also facilitate informed dialogues with regulators.”

B. IOSCO Comments – Strategy and Work Plan, 2010-2012

1. “Overall, we welcome the matters that are described in the Board's Work Plan; however, we have some disappointment that evidently more attention is not planned to be given to the subject of non-audit/non-assurance services in audits of publicly listed companies. In many instances in recent years, IOSCO has raised concerns over various aspects in the Code where the public interest was insufficiently addressed. As noted in our comments below, we observe that many of these concerns are not sufficiently reflected in the current draft Work Plan. We urge the IESBA to reconsider the Work Plan in light of both our previous comments and the discussions in this comment letter, and develop a work plan that will be more robust in addressing public interest matters.”

Appendix B

HIGHLIGHTS OF SELECTED DIFFERENCES BETWEEN CERTAIN KEY REQUIREMENTS UNDER SECTION 290 RELATED TO NON-ASSURANCE SERVICES, AND CORRESPONDING REQUIREMENTS OF CERTAIN KEY JURISDICTIONS

The following comparisons are based on the findings of the benchmarking exercise, *Comparison by Topic of the Independence Requirements in the IESBA Code Relating to the Audit of PIEs to those of Certain Jurisdictions*,⁵ that were presented at the June 2011 IESBA meeting. They are presented for illustrative purposes only.

Assuming Management Responsibility

1. The Code prohibits a firm from assuming “management responsibility” for an audit client [290.165], but generally deems activities that are routine and administrative, or involve matters that are insignificant to not be a management responsibility [290.164].
2. In the US, while SEC independence rules also prohibit an auditor from performing a “management function,” no exception to the management function prohibition is provided for matters that may be considered insignificant, or activities that are routine and administrative in nature. Similarly, under French regulation, acts of “administration” are prohibited.

Preparing Accounting Records and Financial Statements

3. With respect to an audit client that is a PIE, the Code generally prohibits a firm from:
 - (a) Providing accounting and bookkeeping services (including payroll services); or
 - (b) Preparing the client’s financial statements on which the firm will express an opinion or financial information that forms the basis of the financial statements [290.172].

An exception is provided for “emergency situations.”

4. The Code permits a firm to provide accounting and bookkeeping services, including payroll services and the preparation of financial statements or other financial information of a routine or mechanical nature, to audit clients that are PIEs, in certain instances [290.173].
5. Regulatory requirements in the US, Australia, France, Germany and Japan are more restrictive, in that they prohibit either one, or both of these items.

Valuation Services

6. In the case of audit clients that are PIEs, the Code prohibits a firm from providing valuation services, but only to the extent that such services would have a material effect, separately or in the aggregate, on the financial statements [290.180].
7. In the US, under SEC rules, no allowance is provided for immaterial services. Instead, the prohibition applies in respect of the provision of any valuation service, appraisal service, or any service involving a fairness opinion or contribution-in-kind report for an audit client. SEC

⁵ The detailed findings of the benchmarking exercise can be accessed at: <http://www.ifac.org/sites/default/files/meetings/files/6227.pdf>.

independence requirements do provide that the audit firm may perform these and four other “conditionally prohibited” services for an affiliate of an SEC audit client, if it is reasonable to conclude that the results of the particular service will “not be subject to audit procedures” during an audit of the company’s financial statements and, therefore, the firm would not be auditing its own work. This could apply to a parent, other investor, or sister entity.

8. Under French regulation, valuation and actuarial services are prohibited regardless of materiality if they would be utilized in the preparation of accounting or financial information to be included in the financial statements or financial information.