

Extracts from the 11th PIOB Public Report 2015

Below, for information only, are relevant extracts from the 11th PIOB Public Report¹ relating to the IESBA.

Secretary General Report**Driving Behavior**

- The financial crisis of 2008 brought into sharp focus the concerns of investors and others about the effectiveness of external audits and created high expectations regarding the quality and transparency of audits and the professional behavior of auditors. To meet these expectations, the SSBs have introduced changes to auditing and ethical standards. These changes have materialized, or will soon materialize, in four projects²: new standards for the auditor's report, changes to ISA 540 on auditing accounting estimates, the restructuring of the Code of Ethics, and non-compliance with laws and regulations (NOCLAR).
- The restructuring of the Code of Ethics is a major undertaking. The project seeks to improve the visibility of the requirements and prohibitions in the Code, to clarify responsibilities, to simplify the language, and to improve the overall usability of the Code, thereby facilitating its adoption and effective implementation.
- The NOCLAR project is especially important to drive professional behavior. The NOCLAR provisions, approved in 2016, set a new responsibility for the professional accountants to respond to suspected or detected non-compliance with laws and regulations where the response by management or by those charged with governance is not deemed adequate, subject to the existence of a legal framework offering protection to the professional accountant. In these cases, the auditor shall disclose the matter to an appropriate authority "where required by law or regulation or where considered necessary in the public interest." Such disclosure will not be considered a breach of confidentiality by the Code of Ethics for accountants. In the absence of legal protection, the auditor has the option not to report the breach to the authorities, but to withdraw from the assignment.

Establishing a global reporting requirement through an international standard is challenging. Differences exist in the level of protection afforded to professional accountants by varying legal frameworks, the degree to which countries abide by the rule of law, the degree to which members of the International Federation of Accountants (IFAC) meet their commitments, and the compatibility of national laws with the international public interest. However, many jurisdictions require the audited entity to take appropriate measures to deal with such irregularities or else the audit firm is required to inform the authorities. The new standard could help to extend this practice internationally where practicable.

A final expectation is that this new ethical standard will enhance the role of audit firms in protecting the public interest. Public interest considerations may override the principle of confidentiality in jurisdictions where the legal system affords sufficient legal protection for the auditor. From the point of view of the international public interest, this will not be the case in countries where no such

¹ http://www.ipiob.org/media/files/publications/public_reports/Memo15PIOB_web.pdf

² Other projects are being discussed by the boards, including the IAASB projects on quality control, group audits, and professional skepticism and the International Ethics Standards Board (IESBA) project on long association.

protection is offered. A new mind-set and attitude from auditors could also drive a change in behavior in management in line with changes in the new standard.

Monitoring of Comment Letters from MG Members

- In 2015, PIOB staff prepared databases for IAASB and IESBA main projects. These have been published on the PIOB website: <http://www.ipiob.org/index.php/monitoring-of-comment-letters-to-ed>. Copies of the databases have also been distributed to the organizations submitting the letters and to the appropriate SSB and CAG chairs. Publication and distribution of databases will continue in 2016.

Recommendations Made to the IAASB and the IAASB CAG during 2015

WHEN	PUBLIC INTEREST ISSUES	IAASB/IAASBCAG DIRECTION
Revision of ISA 250/NOCLAR		
IAASB March 2015 meeting and IAASB CAG June 2015 conference call	<p>It is important that the IAASB and the IESBA work jointly</p> <p>Gatherings such as presentations made by the IESBA to the IAASB on the NOCLAR project are important. Cooperation between the two SSBs is very important to allow (a) consistency between their exposure drafts and (b) a holistic approach to identifying projects and issues, and assessing consequences for the standards.</p>	<p>The IAASB produced an exposure draft with limited changes to ISA 250 so that the IESBA's exposure draft for NOCLAR and the IAASB's exposure draft for ISA 250 could be sent out for comments at the same time.</p> <p>The IAASB continued receiving</p>

IESBA and IESBA CAG

- The International Ethics Standards Board for Accountants finalized two projects in 2015:
 - "Changes to the Code of Ethics for Professional Accountants Related to Certain Provisions Addressing Non-Assurance Services for Audit and Assurance Clients," which the PIOB agreed were approved in accordance with due process and with proper regard for the public interest. However, noting the limited scope of the project, the PIOB urged the board to revisit issues on auditor's independence from a broader perspective, such as prohibited non-assurance services (NAS), related-fee issues, and the role of those charged with governance in approving NAS.
 - "Review of Part C of the Code"—Phase I—Sections 300, 320, and 370 (and Conforming Changes in Extant Sections 310, 330 and 340) under the current structure and drafting conventions.
- The IESBA also advanced work on other projects:
 - Approved the re-exposure draft of "Responding to Non-Compliance with Laws and Regulation (NOCLAR)" and discussed the comment letters submitted by respondents
 - Discussed and approved the exposure drafts of the "Structure of the Code" and "Safeguards" projects
 - Discussed the comment letters submitted by respondents to the "Long Association of Senior Personnel (including Partner Rotation) with an Audit Client," reviewed the provisions, and decided to re-expose the text to gather public input on the major changes versus the exposure draft

- Agreed on the publication of a staff paper on “Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure.”
- During 2015, the CAG contributed to advance the IESBA projects by providing its input.
- In 2016, the IESBA CAG chair will end his term and a new chair will be either reappointed or elected.
- The observations conducted during the year are shown in Table 7.

Due to the public interest implications of the IESBA projects, the PIOB applied an Oversight Assurance **Model 2** (high intensity) to oversee the IESBA and its CAG in 2015, with 100% direct observations of all board meetings and teleconferences held in the year.

Table 7. PIOB Observations of IESBA and IESBA CAG Meetings in 2015

(**O**: Direct observations / **RO**: Remote observations / **TC**: Teleconferences)

	IESBA					IESBA CAG			
	2015 oversight plan		2015 actual observations			2015 oversight plan		2015 actual observations	
	Nr.	%	Nr	%		Nr.	%	Nr	%
Meetings of which:	4		5		Meetings of which:	2		2	
DO	4	100%	5	100%	DO	2	100%	2	100%
RO	0	0%	0	0%	RO	0	0%	0	0%
TC	2	100%	2	100%	TC	0	n.a.	0	n.a.

IESBA			IESBA CAG		
12 - 14 January	London, UK	Eddy Wymeersch	10 - 11 March	New York, NY USA	Jules Muis
13 - 15 April	New York, NY, USA	Jane Diplock	14 September	New York, NY USA	Chuck Horstmann
29 June - 1 July	New York, NY, USA	Eddy Wymeersch			
15 - 16 September	New York, NY, USA	Chandu Bhavé			
14 October	Teleconference	Eddy Wymeersch			
21 October	Teleconference	Michael Holm			
30 Nov - 4 Dec	New York, NY, USA	Chandu Bhavé			

Recommendations Made to the IESBA and IESBA CAG during 2015

- The public interest implications of the standards under development were high. The PIOB's experience with the IESBA and its CAG during 2015 was positive. Discussions were robust and thorough. Board members and CAG representatives were engaged in the debates and showed awareness of public interest issues.

During the year, PIOB observers raised a number of public interest issues and offered recommendations, to which the board and the CAG responded positively.

WHEN	PUBLIC INTEREST ISSUES	IESBA / IESBA CAG DIRECTION
Non-assurance services (NAS)		
IESBA January meeting	Limited provisions of NAS The NAS provisions do not contain clear-cut prohibitions or a quantitative limit on audit fees.	NAS provisions were approved by the IESBA, acknowledging that the scope of the project was limited to addressing certain specific issues only. The PIOB approved NAS and, noting the limited scope, urged the board to revisit issues on auditor's independence from a broader perspective, such as prohibited NAS, related-fee issues, and the role of those charged with governance in approving NAS. The matter of whether the Code should include new prohibitions is being considered under the Safeguards project. The matter of whether quantitative limits should be placed on fees is being considered under the new fees initiative.

WHEN	PUBLIC INTEREST ISSUES	IESBA / IESBA CAG DIRECTION
IESBA January and June meetings	<p>Relation between audit and non-audit services</p> <p>Given the current audit firm business model, NAS may imply a risk to the audit sector. The increasing importance of non-audit services may generate lower audit fees, poorer-quality staff, and lower remuneration, ultimately weakening the audit function. This evolution should be considered when determining the standards applicable to non-audit services.</p> <p>The Safeguards project should address the matter.</p>	<p>NAS provisions were approved by the IESBA.</p> <p>The PIOB approved NAS and urged the board to revisit issues on auditor's independence from a broader perspective, such as prohibited NAS, related-fee issues, and the role of those charged with governance in approving NAS.</p> <p>The scope of the Safeguards project includes the focus on NAS provisions.</p>
Responding to non-compliance with laws and regulations (NOCLAR)		
IESBA January meeting	<p>Elements considered by the auditor in determining whether to report NOCLAR and documentation</p> <p>The reasons guiding the auditor's judgment on whether to report a NOCLAR should be strengthened. The elements taken into account in the decision-making process should be detailed in the documentation.</p>	<p>The disclosure will depend on the nature and extent of the actual or potential harm that is or may be caused by the matter to investors, creditors, employees, or the general public.</p> <p>The final provisions of NOCLAR, approved in April 2016, include additional examples to guide the professional accountant to determine whether to report.</p> <p>The IESBA agreed to add a new documentation requirement for the auditor (in addition to the documentation requirement in ISAs).</p>
IESBA April meeting	<p>Drafted provisions do not encourage reporting of NOCLAR</p> <p>Some of the examples in the draft may be unhelpful to the decision making expected of the professional accountant. They could be read as deterring rather than encouraging reporting.</p>	<p>The final provisions of NOCLAR include additional examples to guide the professional accountant in the decision making process.</p>
Long association (LA)		
IESBA January meeting	<p>Scope does not include audit firm rotation</p> <p>No reference is made to firm rotation. At least some mention should be made, allowing for firm rotation in jurisdictions where this is mandatory or accepted practice.</p>	<p>The LA project scoped out audit firm rotation and only deals with partner rotation.</p> <p>Audit firm rotation has been added in the most recent provisions (which are being re-exposed) as a jurisdictional element to be considered when determining the cooling-off period of engagement partners (EPs) and EQCRs.</p>
IESBA June meeting	<p>Cooling-off period of EPs and EQCRs in LA provisions should be aligned</p> <p>The regime has now been strengthened for EPs (five-year cooling-off period). Rotation of the other leading auditors should not be more lax as that may be detrimental to audit quality.</p>	<p>Cooling-off period of EQCRs was strengthened, with EQCRs on audits of listed entities required to cool off for five years, and EQCRs on audits of public interest entities (PIEs) other than listed entities required to cool off for three years.</p> <p>The changes in the EQCR cooling-off period are being re-exposed.</p>

WHEN	PUBLIC INTEREST ISSUES	IESBA / IESBA CAG DIRECTION
IESBA June meeting	<p>Weakness of LA provisions</p> <p>The overall weakness of the new regime may affect audit quality and influence the structure of the profession and its attitude toward effective oversight of companies' accounting systems. The regime should be extended to a wider range of PIEs, including (in addition to listed companies) financial institutions and large companies such as government-owned entities, where the need for reliable accounting is significant. Also, the consultancy activity of the EP in the cooling-off period should be described more clearly and limited to specific services for which few or no alternatives are available on the market. Therefore, the IAASB also needs to strengthen the PIE regime.</p>	<p>The LA provisions have been strengthened in some aspects (more stringent cooling-off period for EQCRs), and the main changes are being re-exposed.</p> <p>The IESBA has brought to the IAASB's attention the need to consider whether the scope of the EQCR requirement in ISQC 1 should be broadened to cover a wider range of PIEs in addition to listed entities. This issue was raised in the IAASB's December 2015 invitation to comment (ITC), "Enhancing Audit Quality in the Public Interest."</p>
IESBA October teleconference and CAG September meeting	<p>Complexity of LA provisions</p> <p>The proposal is quite complex and difficult to analyze.</p> <p>The added level of complexity to the code risks taking the focus off of the key independence principles and making understanding, acceptance, application, compliance, and convergence more difficult.</p>	<p>LA provisions are being re-exposed with limited questions on the main changes occurred vs. the original exposure draft.</p> <p>The IESBA concluded that stronger LA provisions are in the public interest and appropriate and that the benefits to increasing public trust in auditor independence outweigh the added complexity.</p> <p>Acknowledging that the revised proposals have added some complexity, the IESBA released a draft staff question and answer publication to facilitate understanding and application of the revised provisions. The publication will be issued with the final pronouncement.</p>
Fee-related issues		
IESBA June meeting	<p>Fee-related issues</p> <p>A multiparty research group, composed of independent academics, should be set up to analyze different aspects of the subject, such as the ratio of audit fees to non-audit fees, the historical developments, the cost of auditing, and the parameters for setting fees. Credibility of this research is essential.</p>	<p>The IESBA has begun initial fact-finding work on fee-related issues and issued a staff publication, "Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure." Further study is anticipated in 2016. Consideration of the nature of and approach to the IESBA's future work will be deliberated in due course.</p>
Review of Part C of the Code		
IESBA October teleconference	<p>Part C of the Code</p> <p>The board should not remove the cross-references to NOCLAR.</p>	<p>Part C of the code includes reference to NOCLAR provisions.</p>