

Meeting: IESBA

Meeting Location: Via Zoom

Meeting Date: July 22, 2020

Agenda Item

3

Benchmarking – International Independence Standards Versus Jurisdictional Level Independence Requirements

Objective of the Session

1. To receive an update on the Working Group's activities to date and provide input to the Working Group's planned approach and timeline.

Objective of the Initiative

2. The objective of the proposed benchmarking project is to provide a robust basis for comparing the provisions of IESBA's Code of Ethics ('the Code') with equivalent provisions in the laws and regulations of other jurisdictions that address:
 - (a) The nature of the relationship between an auditor and an audit client, and
 - (b) The activities and services that may and may not be provided by an auditor to an audit client.

The comparison of these provisions will highlight the similarities and differences between the different independence frameworks.
3. Initially, the Working Group intends to compare the relevant provisions of the Code applicable to [public interest entities](#) ('PIEs') with the equivalent provisions applicable to entities in the US. In due course, it may be appropriate to extend the project to compare the provisions of the Code with equivalent provisions in other jurisdictions (such as the EU).
4. In carrying out such comparison the benchmarking will focus on the existing and proposed provisions and rules. Interpretations and the application of the rules in practice will be considered only if and to the extent they provide necessary information regarding the actual prohibition or permissibility of certain relationships, activities or services.
5. It is not the aim of the initiative to make judgments regarding which framework is more stringent.

Background

6. In March 2020, the IESBA supported an IESBA Staff/Planning Committee recommendation to commission staff to undertake a benchmarking project of the Code's independence framework to the independence framework that is applicable to audits of listed entities in the US. A key objective of the benchmarking is to highlight the changes made to the Code since previous global benchmarking was undertaken (e.g. the [IESBA's 2011 benchmarking](#)).
7. The aim of the benchmarking project is to demonstrate to key stakeholders (such as regulators, national standard setters and audit oversight authorities) how the IESBA's independence framework

has evolved over recent years and how it now compares to one of the most recognized independence frameworks, the US Securities and Exchange Commission (SEC) Rules.

8. Previous benchmarking initiatives indicated that some stakeholders, especially regulators, viewed the independence provisions in the Code as overly principles based. These stakeholders have tended not to focus on specific provisions in the Code, such as prohibited activities, services, interests and relationships.
9. These stakeholders have expressed concern that the Code's conceptual framework approach allows firms too much flexibility and judgment. They perceive the national standards, such as the SEC independence framework, as being clearer, more robust and more enforceable. Most recently, these views were expressed in the context of a review being undertaken by Australia's Parliamentary Joint Committee on Corporations and Financial Services (PJC) into the regulation of auditing in Australia.
10. Such views and perceptions about the Code and its independence provisions appear to be based on an understanding of older versions of the Code. During a five-year process that involved extensive stakeholder consultation, the Code has been revised and restructured and many provisions, including the conceptual framework approach, have been strengthened. Further, the independence provisions are subject to further revision as a result of the NAS and Fees projects.
11. To address the concerns raised above, the Working Group proposes, first, to revisit the previous global benchmarking, starting first with the US. Once the benchmarking in relation to the US independence framework is finalized, consideration will be given to extending the work to cover independence requirements in other major jurisdictions, including the EU - as Phase 2 of the initiative.

Working Group

12. To support the IESBA staff in progressing the benchmarking of such independence frameworks the IESBA established a Working Group as of April 2020. The Working Group members are:
 - Laura Friedrich, Working Group Chair and IESBA Technical Advisor;
 - Richard Fleck, IESBA Member;
 - Denise Canavan, IESBA Technical Advisor.
13. Since its formation in April, the Working Group met twice via teleconference to discuss and determine the issues presented for the IESBA's consideration in this paper.

Matters for Consideration

Basis for Benchmarking and Scope of Comparison

14. The Working Group proposes to compare the initial benchmarking exercise on the independence requirements issued by the SEC and by the Public Company Accounting Oversight Board (PCAOB) against the Code's provisions – both requirements and application material - related to the independence of audit clients that are PIEs.¹ The benchmarking will incorporate the revisions arising from the NAS and Fees projects.

¹ Based on the [Strategy and Working Plan of AICPA Professional Ethics Division](#), the American Institute of Certified Public Accountants (AICPA) staff is also planning to compare the AICPA Code to the revised restructured IESBA Code and identify where the AICPA Code is less restrictive than the IESBA Code.

15. The Working Group's intention is to develop a comparison of the IESBA and US independence framework that is as comprehensive as possible so as to fulfil the expectations outlined above and to be credible to stakeholders. This comprehensive approach will enable the IESBA to provide information on comparability between frameworks with respect to any issues in question, such as permissibility of NAS to an audit client, consideration of related entities or public disclosure of fee-related information.

SEC/PCAOB Rules

16. Against the Code's provisions, the Working Group will take into consideration the following specific rules:

- Federal Statutes

Statutes governing public company auditor independence include:

- Securities Exchange Act of 1934 - [Section 10A - Audit Requirements](#)
- Sarbanes Oxley Act of 2002 - [Title II - Auditor Independence](#)

- SEC Rules

The SEC adopted and revised [Rule 2-01](#), Qualifications of Accountants (codified within the Code of Federal Regulations (CFR) 17 CFR Part 210 - Regulation S-X) to implement the auditor independence requirements within the statutes noted above.

Rule 2-01 was revised in 2000, 2003 and 2019.² The amendments are explained in the respective releases:

- [SEC Release \(2000\) - Revision of the Commission's Auditor Independence Requirements](#)
- [SEC Release \(2003\) - Strengthening the Commission's Requirements Regarding Auditor Independence](#)
- [SEC Release \(2019\) - Auditor Independence with Respect to Certain Loans or Debtor-Creditor Relationships](#)

- PCAOB Rules

Firms registered with PCAOB are also required to comply with PCAOB's [ethics and independence rules](#) when conducting an audit that is subject to such standards. These rules have been adopted by the PCAOB and approved by SEC.

Additionally, the PCAOB adopted certain preexisting ethics and independence interim standards.

- Interim Ethics Standards consist of ethics standards described in the [AICPA's Code of Professional Conduct Rule 102](#), and interpretations and rulings thereunder, as in existence on April 16, 2003, to the extent not superseded or amended by the PCAOB.

² In December 2019 [SEC has released proposed changes to Rule 2-01](#) with commenting deadline until March 2020. The Working Group will follow the updates to these proposals.

- Interim Independence Standards consist of independence standards described in the [AICPA's Code of Professional Conduct Rule 101](#), and interpretations and rulings thereunder, as in existence on April 16, 2003, to the extent not superseded or amended by the PCAOB.
15. The PCAOB's rules (and interim independence standards) do not supersede the SEC's auditor independence rules. Where a provision of the SEC's rule is more restrictive - or less restrictive - than the PCAOB's independence standards, a registered public accounting firm must comply with the more restrictive rule.
16. With regard to the complexity of SEC/PCAOB rules, the Working Group proposes to take an incremental approach and focus primarily on the SEC rules, involving only those PCAOB rules that have been adopted by the PCAOB. In case of any significant difference between the PCAOB interim standards and SEC rules the Working Group will raise the issue in a separate note.

Methodology and Structure of Comparison

17. In 2011, the IESBA carried out a comparison of the independence requirements of the IESBA Code relating to the audit of PIEs to those of certain jurisdictions, including the US. The [agenda paper](#) presented to the IESBA at that time summarized the results of the comparison by topic, allowing the reader to focus in on a topic of interest quite quickly.

Comparison of Specific Provisions

18. For the current project, the underlying benchmarking data will be structured in a database format, to allow for sorting on the basis of any framework in the mapping, and to ensure that a comprehensive set of relevant topics is captured.
19. To provide as comprehensive a comparison as possible, **the WG proposes to carry out the benchmarking paragraph by paragraph, following the Code's structure.** (See [PCAOB OCA staff comparison to analogous IAASB standards](#) for an example of this approach). This methodology will provide a systematic analysis and a more sustainable output, as future Code changes can be quickly identified and evaluated. This approach also facilitates expansion to include the additional jurisdictional frameworks desired. This approach does, however, require careful up-front design in order to ensure that the output is appropriately accessible and flexible to accommodate the needs of the user.
20. The comprehensive benchmarking database is likely to be too extensive to be used directly by most stakeholders. Accordingly, **summary information resulting from the initiative will be presented in a format that is most responsive to stakeholder needs.**

Comparison of General Independence Provisions

21. The Working Group recognizes that it is relevant to provide users of the comparison with information regarding the conceptual approach of the Code's and SEC's independence frameworks. The Code's building blocks architecture and how it applies to the application of the International Independence Standards (IIS) is not yet well understood by some stakeholders.³ Therefore, the Working Group

³ [Installment 5](#) of the *Exploring the IESBA Code* publication series explains the application of the Code's conceptual framework to independence.

believes that progressing this benchmarking initiative will be most efficient if the Code's current independence framework, not only the IIS, is documented and promoted among stakeholders.

22. Since the conceptual approach to the SEC/PCAOB independence framework and the conceptual framework in the Code cannot be presented as part of the paragraph by paragraph comparison, the Working Group proposes the inclusion of an introductory section that would summarize the bases of these two frameworks and their overarching approach. Such an overview will also be an important element to address stakeholders' perceptions that the Code and the SEC/PCAOB Rules are either entirely "principles-based" or "entirely rules-based".
23. [Rule 2-01](#) provides a general standard of auditor independence as well as specifying circumstances in which an auditor's independence is impaired. A general standard is established in paragraph (b) that recognizes that an auditor must be independent in fact and appearance. Paragraph (c) then ties that general standard to specific applications and addresses separately situations in which an accountant is not independent of an audit client as a result of (1) financial relationships, (2) employment relationships, (3) business relationships, (4) transactions or situations involving the provision of non-audit services, or (5) transactions or situations involving the receipt of contingent fees. (See Appendix I).
24. The "overarching approach" section of the benchmarking would provide information to demonstrate that both the independence framework of the Code and the SEC/PCAOB rules include strong overarching principles that are supported with specific requirements. Furthermore, both independence frameworks aim to achieve the similar fundamental objectives concerning auditor's independence. (See Appendix II). During the IESBA session, the Working Group Chair will present the Working Group's preliminary thoughts on such comparison. (See agenda item 3-A).

Proposed Timeline and Output

25. One of the purposes of this initiative is to raise awareness of the proposed changes to the IIS arising from the NAS and Fees Project. As significant part of the benchmarking relates to Section 600, *Provision of Non-Assurance Services to an Audit Client*, the Working Group aims to coordinate the benchmarking with the approval of proposed revisions to the NAS and Fee-related provisions of the Code. The Working Group plans to provide an update to the IESBA next once the NAS and Fees Projects are finalized.
26. The Working Group anticipates indicative timing as follows:

Indicative Timing	Milestone
March 2021	<ul style="list-style-type: none">• Provide an update to the IESBA on the progress, including a demonstration of the mapping structure• Discuss with the IESBA the Working Group's analysis of the main differences it has identified throughout the comparison
June 2021	Finalization of Phase I of the benchmarking – Final Report

27. The Working Group recognizes that independence frameworks are not static and the benchmarking can only provide comparison to effective requirements at a specific point in time. Accordingly, the Working Group aims to capture imminent changes to the IESBA's and SEC's independence frameworks that are anticipated, such as changes to the IESBA provisions related to NAS and Fees, and changes to the US framework resulting from the SEC's recent consultation on suggested proposed changes to Rule 2-01. Therefore, the Working Group will follow the updates to the relevant proposed amendments and, if necessary, adjust the timeline of the initiative accordingly.

Actions Requested

28. The IESBA is asked to consider and provide feedback on:
- (a) The proposed basis for benchmarking and scope of the comparison,
 - (b) The proposed methodology and structure of the comparison,
 - (c) Any specific areas of comparison that might be particularly informative, and
 - (d) The anticipated timeline for the initiative.

Material Presented

Agenda Item 3-A Slide Presentation – IESBA Benchmarking Initiative

Extract of SEC Adopted and Revised Rule 2-01, Qualifications of Accountants

§210.2-01 Qualifications of accountants.

Preliminary Note to §210.2-01

1. Section 210.2-01 is designed to ensure that auditors are qualified and independent of their audit clients both in fact and in appearance. Accordingly, the rule sets forth restrictions on financial, employment, and business relationships between an accountant and an audit client and restrictions on an accountant providing certain non-audit services to an audit client.

2. Section 210.2-01(b) sets forth the general standard of auditor independence. Paragraphs (c)(1) to (c)(5) reflect the application of the general standard to particular circumstances. The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standard in §210.2-01(b). In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: creates a mutual or conflicting interest between the accountant and the audit client; places the accountant in the position of auditing his or her own work; results in the accountant acting as management or an employee of the audit client; or places the accountant in a position of being an advocate for the audit client.

3. These factors are general guidance only and their application may depend on particular facts and circumstances. For that reason, §210.2-01 provides that, in determining whether an accountant is independent, the Commission will consider all relevant facts and circumstances. For the same reason, registrants and accountants are encouraged to consult with the Commission's Office of the Chief Accountant before entering into relationships, including relationships involving the provision of services, that are not explicitly described in the rule.

(a) The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(b) The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.

(c) This paragraph sets forth a non-exclusive specification of circumstances inconsistent with paragraph (b) of this section.

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Extract of SEC 2000 Release

Below is an extract from the SEC Release (2000) entitled *"Final Rule: Revision of the Commission's Auditor Independence Requirements"* explaining the U.S. conceptual approach in comparison to the Code's principles-based approach.

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C. Independence Concerns Warrant Restrictions on the Scope of Services Provided to Audit Clients

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10. The Final Rules Encourage International Efforts in This Area

"Foreign companies increasingly seek to raise capital in the U.S. securities markets, and holdings by U.S. investors of foreign company securities have risen. With the increasing globalization of the markets, regulators worldwide have been re-examining current regulatory requirements applicable to cross-border offerings. We, and regulators around the world, have an interest in promoting high quality international accounting, auditing, and independence standards, while at the same time preserving or enhancing existing investor protections."...

The International Federation of Accountants ("IFAC"), in which the accounting profession participates actively, has several recent initiatives to establish global auditing standards. Most recently, the IFAC Ethics Committee issued for comment an Exposure Draft proposing a framework for independence. In the Exposure Draft, IFAC presents a conceptual or principle-based approach to addressing auditor independence.⁴ Some commenters on our proposal, particularly foreign-based firms and organizations such as the Federation Des Experts Comptables Europeens ("FEE"), suggested that we too adopt a conceptual approach, as opposed to a rules-based approach. Several of these commenters argued that while a rules-based approach has certain advantages and is consistent with the historical U.S. approach, a conceptual approach, particularly in the area of non-audit services, is more efficient and flexible.

We understand that many regulators do not agree with the conceptual approach, and several foreign countries prohibit certain non-audit services though standards vary from country to country. Standards vary for a number of reasons, including that in some countries, audits are conducted by statutory auditors who are directly responsible to shareholders, and in some cases audits may be conducted for other than financial reporting purposes.

We believe that our final rules combine important and useful elements of both approaches. As noted, Rule 2-01(c) does not set forth all circumstances that may impair an auditor's independence from its audit client. For other services, and in particular future services, the Preliminary Note makes clear that in applying the general standard in Rule 2-01(b), we will look in the first instance to the four factors. The four factors provide guiding principles for the Commission, similar to what a "conceptual approach" would provide.

We recognize that our system of regulation is not universal. We have worked, and will continue to work closely, both directly and through IOSCO, with our foreign counterparts on the important issue of auditor independence."

...

⁴ The SEC Release refers to the proposed independence framework as set out in the IFAC Ethics Committee, *Independence: Proposed Changes to the Code of Ethics for Professional Accountants* (Exposure Draft: Sept. 15, 2000). The Code's independence provisions have been substantively revised since 2000. [Installment 5](#) of the *Exploring the IESBA Code* publication series provides an overview of the Code's conceptual framework to independence.