

## Benchmarking International Independence Standards Phase 1 Report

### *Comparison of IESBA and US SEC/ PCAOB Frameworks*

*As of March 3, 2022*

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**--This draft is subject to final quality control checks--**

### Note to CAG Representatives

After the March 2022 meeting, this document, and the accompanying summary (see **Agenda Item F-2**) will be subject to a final consistency review, quality control checks as well as design enhancements (e.g., hyperlinks will be added to direct readers to specific sections of the Code).

The final release package will include a short publication that among other matters will:

- Reiterate the purpose of the reports, including the anticipated benefits to stakeholders.
- Indicate the planned approach and timeframe for updates/ maintenance to the reports so that they reflect relevant changes to the Code as they are adopted.

## I. Introduction

### A. Objective of the Benchmarking Initiative

1. The IESBA's Benchmarking Initiative compares the provisions of the IESBA's [International Code of Ethics for Professional Accountants \(including International Independence Standards\)](#), (the Code) with corresponding provisions in the laws and regulations of other jurisdictions that address auditor independence, including:
  - (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.
2. The comparison is intended to highlight the similarities and differences between the Code and the different jurisdictional-level independence rules and regulations. This initiative does not extend to making judgments as to the relative merits of the different approaches, rules or regulations.
3. The objective of this initiative is to promote awareness and adoption of the current version of the Code, especially the International Independence Standards (IIS).<sup>1</sup> The outcome of each benchmarking will provide insights to stakeholders who are interested in further understanding the aspects of jurisdiction-level provisions that differ from or go beyond those set out in the Code. It will also help the IESBA to identify any specific provisions of the Code (including IIS) that it should review and, if appropriate, address as part of its 2024-2027 Strategy and Work plan.

### B. About this Report

4. This report together with the accompanying Executive Summary [<add link>](#) summarizes the outcome of Phase I of the IESBA's Benchmarking Initiative. The initiative responds to specific stakeholders' questions about how the current IIS that are applicable to public interest entities

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<sup>1</sup> The current version of the Code includes the most recent version of the Code, including revisions that will become effective in December 2022 (i.e., revisions relating to the objectivity of an engagement quality reviewer and other appropriate reviewers, and the revised non-assurance service (NAS) and fee-related provisions of the Code), as well as the revisions that the IESBA approved in December 2021 that are subject to approval by the Public Interest Oversight Board (i.e., the quality management-related conforming amendments to the Code, and the revisions relating to the definitions of listed entity and public interest entity).

To access the Code and to obtain final pronouncements issued subsequent to April 2021, visit the IESBA's website at: [www.ethicsboard.org/standards-pronouncements](http://www.ethicsboard.org/standards-pronouncements).

(PIEs)<sup>2</sup> compare with the independence requirements for entities subject to the US Securities and Exchange Commission (SEC/ the Commission) and the US Public Company Accounting Oversight Board (PCAOB) (collectively “SEC/PCAOB”). The comparison in this report (the “Report”) focuses primarily on the independence requirements of the SEC and refers to the PCAOB independence requirements only where those requirements are incremental to those of the SEC rules.

5. This Report does not make qualitative comparisons between the provisions of the Code and the SEC/PCAOB requirements (such as whether one framework is more stringent or rigorous than the other) because:
- The two frameworks are not directly comparable. As explained in Section II, they have different jurisdictional bases and adopt different conceptual approaches.
  - Perceptions about the alternative approaches and particular provisions might vary depending on the perspective of the reader – a standard-setting body adopting the Code might have a different focus to that of a regulator.

The analysis in this Report therefore focuses on whether the provisions/rules address the same issues and intend to achieve comparable outcomes.

6. This Report does not amend or override the Code or the SEC and PCAOB rules, the texts of which alone are authoritative, and does not constitute an authoritative or official pronouncement of the IESBA. Reading this Report is not a substitute for reading the Code or the SEC and PCAOB rules. Readers are also cautioned to apply judgment in reading and interpreting this Report within the context of their jurisdiction.
7. This Report does not necessarily include all the aspects and conditions in the Code or the SEC and PCAOB rules. It is not an interpretation of the relevant provisions/rules and should not be viewed as such. The Report refers to the relevant provisions/rules to the extent necessary for analysis and comparison.

## **C. Focus Areas and Topics**

8. This Report reflects the IESBA Staff’s understanding of the respective frameworks being compared and incorporates input from the IESBA’s Benchmarking Working Group, as well as the IESBA. The IESBA’s Consultative Advisory Group (CAG) and the IESBA-National Standard Setters Liaison Group (NSS) provided insights and perspectives that helped inform the structure of the report. In particular, their views helped in identifying the focus areas and topics to be covered.
9. This Report includes a consideration of overarching principles and approach (Section II), key definitions (Section III) and focus areas and topics (Section IV) that are of greatest interest to IESBA, users of the Code and other stakeholders. These focus areas and topics include:
- Fee-related Provisions
  - Non-Assurance/ Non-audit Services – General Provisions
  - Non-Assurance/ Non-audit Services – Specific Provisions
  - Communication with Those Charged with Governance (TCWG)

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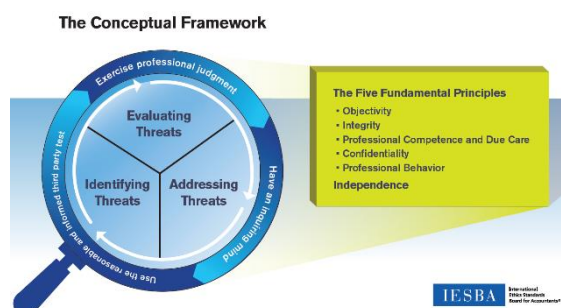
<sup>2</sup> The IESBA unanimously approved revisions to the Code’s definition of a PIE in December 2021. Subject to Public Interest Oversight Board’s (PIOB) approval, the final pronouncement is expected to be released by April 2022 and will be available on the [IESBA’s website](#). The revised PIE definition will become effective in December 2024.

- Financial Relationships
  - Business Relationships
  - Partner Rotation/Long Association
  - Gifts and Hospitality
  - Non-Compliance with Laws and Regulations (NOCLAR)
10. The focus areas and topics dealt with in this Report does not imply that these areas are more important to auditor independence than other topics or standards that were not covered.

## II. Overarching Principles and Approach

### A. The Fundamental Principles, Independence and the Conceptual Framework

11. The Code establishes five fundamental principles with which all professional accountants and firms<sup>3</sup> are required to comply in all circumstances. The Code also requires accountants to apply a specified conceptual framework to identify, evaluate and address threats to compliance with those fundamental principles. Applying the conceptual framework requires having an inquiring mind, exercising professional judgement, and using the reasonable and informed third party test.



12. Under the Code's conceptual framework, a professional accountant is required to identify whether any threat to compliance with the fundamental principles exists and, if so, to evaluate that threat to determine whether it is at an acceptable level.<sup>4</sup> If the threat is not at an acceptable level, the conceptual framework requires the accountant to address that threat having regard to the facts and circumstances by either:
- Eliminating the circumstances, interests or relationships that are creating the threat;
  - Applying safeguards, where available and capable of being applied, to reduce the threat to an acceptable level; or
  - Declining or ending the specific professional activity (or engagement that gives rise to the threat).

<sup>3</sup> The term "firm" used in this Report is based on the Glossary of the Code definition and includes:

- (a) A sole practitioner, partnership or corporation of professional accountants;
- (b) An entity that controls such parties, through ownership, management or other means; and
- (c) An entity controlled by such parties, through ownership, management or other means

<sup>4</sup> The Code's conceptual framework provides descriptions and definitions of key terms and concepts, including:

- Acceptable level – a level at which a professional accountant using the reasonable and informed third party test would likely conclude that the accountant complies with the fundamental principles (see paragraph 120.7A1).
- Reasonable and informed third party – a consideration by the professional accountant about whether the same conclusions would be reached by another party (see paragraph 120.7 A1).
- Safeguards – actions, individually or in combination, that the professional accountant takes that effectively reduces threats to compliance with the fundamental principles (and to independence) to an acceptable level (see paragraphs 120.10 A2).

The Code notes that there are some situations in which threats can only be addressed by declining or ending the professional activity. This arises when the circumstances creating the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threat to an acceptable level.<sup>5</sup>

### *International Independence Standards (IIS)*

13. In addition to complying with the fundamental principles, the IIS require professional accountants in public practice (PAPPs), including firms to be independent, both in fact and in appearance, when performing audit, review, and other assurance engagements. Firms are required to apply the Code's conceptual framework to identify, evaluate, and address threats to independence in relation to an audit engagement. The IIS provides additional requirements and application material that are relevant to the application of the conceptual framework, including examples of safeguards that might be applied to reduce a threat to independence to an acceptable level.

### *Structure of the Code*

14. The Code's requirements and application material ((including the IIS') are collectively referred to as the Code's "provisions." The Code's provisions are interconnected by design—using a ["building blocks approach"](#) and drafting conventions that minimize duplication. Therefore, the provisions in Part 1 apply equally across all professional activities and are not repeated in Parts 2, 3 and 4, except for emphasis. This approach demonstrates the scalability of the Code's provisions and emphasizes the overarching principles-based provisions that apply to all accountants in all situations.
15. The Code's requirements are designated with the letter "R" and in most cases include the word "shall". Some requirements explicitly prohibit certain relationships between the auditor and the audit client, or the provision of particular activities or services to the audit client. The Code also includes application material which provides context that is relevant to a proper understanding of the requirement or provision to which it relates. While such application material does not itself impose a requirement, consideration of the material is necessary for the proper application of the requirements of the Code, including the application of the conceptual framework. Application material is designated with the letter "A".
16. The IIS include additional requirements and application material that are applicable when a professional accountant provides professional services to a "PIE, a category that includes entities listed on a recognized stock exchange or other equivalent body, i.e., listed entities under the Code's framework. (See Section III, Audit Client and Related Entities below).

## **B. The SEC/PCAOB Rules**

### *SEC Rules*

17. The independence rules of the SEC must be complied with for audits required by US federal securities laws, including audits of the financial statements of issuers<sup>6</sup> (and other entities)<sup>7</sup>.

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<sup>5</sup> See paragraph 120.10 A1 of the Code

<sup>6</sup> Based on Sarbanes Oxley Act of 2002, Section (2)(a)(7), the term "issuer" means an issuer (as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

<sup>7</sup> Audits of other entities that are subject to the SEC rules include but are not limited to investment advisors, broker dealers, and funds that satisfy the custody rule.

Regulation S-X<sup>8</sup> sets out the form and content of, and requirements for, financial statements required to be filed with the Commission, including the requirements for auditor independence.

18. [Rule 2-01 of Regulation S-X](#) requires auditors to be qualified and independent of their audit clients both in fact and in appearance. Accordingly, Rule 2-01 sets out restrictions, among others, on financial, employment, and business relationships between an accountant<sup>9</sup> and an audit client and restrictions on an accountant providing certain non-audit services to an audit client.<sup>10</sup>
19. Rule 2-01(b)<sup>11</sup> provides, as a general standard of auditor independence, that:

*“The [Securities and Exchange] 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.”*
20. Rule 2-01(c)<sup>12</sup> includes a non-exclusive list of specific rules and restrictions that are intended to reflect the general standard’s application to particular circumstances. However, in cases where Rule 2-01 (c) does not address specific situations or circumstances, accountants are required to consider the general standard to determine whether their independence is compromised.
21. To achieve this, Rule 2-01<sup>13</sup> states that “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.”

#### PCAOB Rules

22. Audits of issuers (and broker-dealers) must also be performed in accordance with the requirements of the PCAOB, following their approval by the SEC. The PCAOB adopted ethics

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<sup>8</sup> 17 C.F.R. Part 210

<sup>9</sup> Based on SEC rules, “accountant” in this Report means a registered public accounting firm, certified public accountant or public accountant performing services in connection with an engagement for which independence is required. References to the accountant include any accounting firm with which the certified public accountant or public accountant is affiliated. (SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (1))

<sup>10</sup> In considering Regulation S-X, regard has been given to the following independence related amendments:

- [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](#)
- [SEC Release \(2020\) – Qualification of Accountants](#)

<sup>11</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (b)

<sup>12</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c)

<sup>13</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 Introductory note

*\*\*As of March 3, 2022 \*\**

and independence standards and rules (i) issued by the PCAOB ([PCAOB rules<sup>14</sup>](#)), and (ii) - on an interim basis – promulgated by other bodies, including the AICPA ([Interim Ethics and Independence Standards<sup>15</sup>](#)). The Interim Ethics and Independence Standards consist of:

- The Ethics and independence standards in the AICPA's Code of Professional Conduct, and interpretations and rulings thereunder, in existence on April 16, 2003, to the extent not superseded or amended by the PCAOB, and
  - The Independence Standards of the Independence Standards Board.
23. The PCAOB did not adopt the SEC independence rules, as those rules were already applicable to auditors of SEC issuers. Where SEC rules and PCAOB rules and Interim Ethics and Independence Standards are not equivalent, auditors of issuers (and broker-dealers) are required to comply with the more restrictive provision.<sup>16</sup> PCAOB Rule 3520 further provides that PCAOB registered firms and their associated persons must comply with both PCAOB and SEC independence criteria.
24. In preparing this Report, the IESBA Staff took an incremental approach by focusing primarily on the SEC rules and then considering those PCAOB rules that are more restrictive than the SEC Rules. The Report only includes references to PCAOB's Rules and Interim [Ethics and Independence Rules and Interim Standards](#) when, based on IESBA Staff's evaluation, those are incremental to the SEC rules.

## C. The IESBA and SEC/PCAOB Frameworks Compared

### *Global Framework / Jurisdictional Framework*

25. The Code and the SEC/PCAOB rules were developed for application in different circumstances, which result in different approaches in terms of applicability and use. In particular:
- (a) The Code applies to all professional accountants irrespective of the professional activity

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<sup>14</sup> The PCAOB rules include:

- [3501 Definitions of Terms Employed in Section 3, Part 5 of the Rules](#)
- [3502 Responsibility Not to Knowingly or Recklessly Contribute to Violations](#)
- [3520 Auditor Independence](#)
- [3521 Contingent Fees](#)
- [3522 Tax Transactions](#)
- [3523 Tax Services for Persons in Financial Reporting Oversight Roles](#)
- [3524 Audit Committee Pre-approval of Certain Tax Services](#)
- [3525 Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting](#)
- [3526 Communication with Audit Committees Concerning Independence](#)

<sup>15</sup> The PCAOB's Interim Ethics and Independence Standards consist of:

- [ET Section 101 - Independence](#)
- [ET Section 102 - Integrity and Objectivity](#)
- [ET Section 191 - Ethics Rulings on Independence, Integrity, and Objectivity](#)
- [ISB No. 2 Certain Independence Implications of Audits of Mutual Funds and Related Entities\(PDF\)](#)
- [ISB No. 3 Employment with Audit Clients \(PDF\)](#)
- [ISB Interpretation 99-1 Impact on Auditor Independence of Assisting Clients in the Implementation of FAS 133 \(Derivatives\)](#)

<sup>16</sup> In late 2020, the PCAOB made targeted conforming amendments to their independence rules to (i) avoid differences between the SEC and PCAOB independence rules; (ii) avoid duplicative requirements; and (iii) provide greater regulatory certainty.(PCAOB Release No. 2020-003, November 19, 2020)



undertaken, with IIS that apply to PAPPs (including firms) performing audits, reviews or other assurance engagements for all entities. The SEC and PCAOB rules apply to auditors of issuers, as well as certain other entities where compliance with SEC Rule 2-01 and the PCAOB rules is required.

- (b) The Code is developed for use and adoption in any jurisdiction in the world and its application relies on national laws and regulations in that jurisdiction.<sup>17</sup> The SEC and PCAOB rules are developed for application in accordance with the relevant US legislation and regulation.
- (c) The IESBA Code applies when professional activities/ services are provided to any entity, irrespective of size, business and market specificities. As there is a heightened expectation regarding the independence of firms auditing PIEs, the Code includes specific provisions addressing relationships with and services provided to those entities. The SEC/PCAOB rules address the relationships and provision of services to audit clients for which the SEC independence rules apply, which have greater relevance from the public interest point of view.

#### *Application of the Conceptual Framework / General Independence Standard*

- 26. Neither the Code nor the SEC framework is entirely “rules-based” or entirely “principles-based”. Both frameworks include strong overarching principles that are supported with specific requirements.
- 27. Under both the Code and the SEC rules, the determination of “independence” requires consideration of both independence in mind/in fact and independence in appearance:

Code's Provisions	SEC Rules
<b>Independence in mind / independence in fact</b>	
“Independence of mind - the state of mind that permits the <u>expression of a conclusion without being affected by influences that compromise professional judgment</u> , thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.”	“The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, (...) capable of <u>exercising objective and impartial judgment on all issues</u> encompassed within the accountant's engagement.”
<b>Independence in appearance</b>	
“Independence in appearance - the avoidance of facts and circumstances that are so significant that <u>a reasonable and informed third party would be likely to conclude that a firm's, or an audit team member's, integrity, objectivity or</u>	“The Commission will not recognize an accountant as independent, with respect to an audit client, if (...) <u>a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising</u>

<sup>17</sup> Members of the International Federation of Accountants (IFAC) are required to adopt and implement ethics standards, including independence requirements, that are no less stringent than those in the Code. Professional accountants need to be mindful and take into consideration that some jurisdictions might have provisions that differ from or go beyond those set out in the Code. In these jurisdictions, accountants need to be aware of those differences and comply with the more stringent provisions unless prohibited by law or regulation. Additional information about the status of adoption of international standards, including the Code is available on [IFAC's website](#).



<u>professional skepticism has been compromised.</u>	<u>objective and impartial judgment on all issues</u> encompassed within the accountant's engagement."
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28. Under both frameworks, the concept of a "reasonable and informed third party" test / "reasonable investor with knowledge of all relevant facts and circumstances" test has a significant role in the assessment of a firm's independence. In the Code, the "reasonable and informed third party test" is also a basis for evaluating whether a threat to independence is at an acceptable level. When applying the general standard in the SEC rules in circumstances other than those specifically addressed by Rule 2-01(c), the four principles in paragraph 21 of this Report should be applied when considering Rule 2-01(b) in determining whether the accountant is independent.
29. Both frameworks set out similar fundamental objectives (or principles) by which an auditor's independence is assessed (i.e., applying the Code's conceptual framework to independence or determining compliance with the SEC's general independence standard). The table below provides a comparison of the high-level concepts of the fundamental objectives (or principles) from each framework.<sup>18</sup>

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<sup>18</sup> The specific provisions supporting these objectives (or principles) are presented in the sections below.

<p><i>Concepts in IESBA's Conceptual Framework and Overarching Principles to Independence that are Analogous to SEC's General Standard</i></p>	<p><b>SEC's Rule 2-01 Introductory Note<sup>19</sup></b></p> <p>"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:"</p>
<p>A professional accountant shall not allow a conflict of interest to compromise professional or business judgment.<sup>20</sup></p>	<ul style="list-style-type: none"> <li>• Creates a mutual or conflicting interest between the accountant and the audit client</li> </ul>
<p>Self-interest threat – the threat that a financial or other interest will inappropriately influence a professional accountant's judgment or behavior.<sup>21</sup></p>	
<p>Familiarity threat – the threat that due to a long or close relationship with a client, or employing organization, a professional accountant will be too sympathetic to their interests or too accepting of their work.<sup>22</sup></p>	
<p>Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.<sup>23</sup></p>	
<p>Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made; or an activity performed by the accountant, or by another individual within the accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity.<sup>24</sup></p>	<ul style="list-style-type: none"> <li>• Places the accountant in the position of auditing his or her own work.</li> </ul>
<p>A firm or a network firm shall not assume a management responsibility for an audit client.<sup>25</sup></p>	<ul style="list-style-type: none"> <li>• Results in the accountant acting as management or an employee of the audit client</li> </ul>
<p>Advocacy threat – the threat that a professional accountant will promote a client's or employing organization's position to the point that the accountant's objectivity is compromised.<sup>26</sup></p>	<ul style="list-style-type: none"> <li>• Places the accountant in a position of being an advocate for the audit client.</li> </ul>

<sup>19</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (b)

### *Determination of Threats to Independence*

30. Although both frameworks set out similar fundamental objectives (or principles), the assessment and the application of those principles are different in the two independence frameworks.
31. Under the Code, provided the relationship or provision of a specific service is not explicitly prohibited, the application of the conceptual framework requires the firm to identify threats to compliance with the fundamental principles, to evaluate the level of a threat identified and then to determine whether any safeguards are available and capable of reducing that threat to an acceptable level (see also Section II, A). If appropriate safeguards are not capable of being applied or are not available, the Code requires the firm to eliminate the circumstances that are creating the threats, or end the specific professional activity.

The Code's NAS provisions provide additional requirements and application material for addressing threats to independence, including specific examples of actions that might be NAS safeguards. In addition, the Code's NAS provisions prohibit the provision of NAS that might create a self-review threat to audit clients that are PIEs. See sections IV, B and C of this Report.

32. The SEC's framework requires an auditor to determine whether the provision of a particular service or relationship would result in a breach/violation of the overarching principles and, if so, prohibits the provision of that service or relationship regardless of the materiality or significance of the breach/violation.

### *Commentary*

33. The conceptual framework and the general independence standard each prescribe different processes for the determination of whether a relationship or service is prohibited. Provided that a proposed service or relationship is not explicitly prohibited,
- The conceptual framework in the Code focuses on the possibility that a service or relationship might give rise to a threat – and then on whether that potential threat is at or can be reduced to an acceptable level. The service or relationship is prohibited if the threat cannot be eliminated or reduced to an acceptable level.
  - By contrast, the SEC prohibits services or relationships that would involve a breach of the overarching principles. The SEC rules do not permit safeguards to address situations where a service or relationship would otherwise breach the overarching principles. As a result, an accountant's assessment focuses on whether any of the overarching principles will be breached.
34. An all-encompassing comparative evaluation is, therefore, not possible as much will depend on the specific circumstances.

<sup>20</sup> Part III – Professional Accountant in Business, Section 310, Conflict of Interest, paragraph R310.4. Based on the Code's building blocks approach, requirements and application material in Part III of the Code are also applicable in the context of the IIS.

<sup>21</sup> Paragraph 120.6 A3(a) of the Code

<sup>22</sup> Paragraph 120.6 A3(d) of the Code

<sup>23</sup> Paragraph 120.6 A3(e) of the Code

<sup>24</sup> Paragraph 120.6 A3(d) of the Code

<sup>25</sup> Paragraph R410.13 of the Code

<sup>26</sup> Paragraph 120.6 A3(c) of the Code

### *Assuming Management Responsibility*

35. The Code prohibits firms or network firms assuming a management responsibility for an audit client.<sup>27</sup> It provides that management responsibility involves “controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.”<sup>28</sup>
36. The Code sets out criteria that firms are required to meet to demonstrate that the management of the audit client makes all judgments and decisions that are management’s proper responsibility, and that a designated competent employee will take ultimate responsibility for any actions arising from the activities. Under the Code, a firm will not be regarded as assuming management responsibility if it complies with these criteria.<sup>29</sup>
37. As an exception to the requirement, a firm or a network firm may assume management responsibilities in respect of the following related entities of an audit client provided that specified conditions are satisfied including that the firm or a network firm does not express an opinion on the financial statements of the related entity:
  - (a) An entity that has direct or indirect control over the client (i.e., parent entity);
  - (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; or
  - (c) An entity which is under common control with the client (i.e., a sister entity).
38. The SEC rules, as one of the overarching principles, prohibits an accountant acting as management or as an employee of an audit client.
39. In addition to this overarching prohibition, the SEC rules include a specific prohibition on the provision of any non-audit service that would constitute a management function, i.e., “acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.”
40. The table below includes the relevant provisions of the Code and SEC rules:

Code’s Revised NAS Provisions		SEC Rules
R400.13	A firm or a network firm shall not assume a management responsibility for an audit client.	2-01 (b) <sup>30</sup> In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service (....) results in the accountant acting as management or an employee of the audit client; (....)
400.13 A1	Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and	
		2-01 (c) (4) <sup>31</sup> An accountant is not independent if, at any point during the audit and

<sup>27</sup> See paragraph R400.13 of the Code. Paragraph 400.13 A2 of the Code states that: “When a firm or a network firm assumes a management responsibility for an audit client, self-review, self-interest and familiarity threats are created. Assuming a management responsibility might also create an advocacy threat because the firm or network firm becomes too closely aligned with the views and interests of management.”

<sup>28</sup> Revised paragraph 400.13 A1 of the Code

<sup>29</sup> Revised paragraph R400.14 of the Code

<sup>30</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (b)

<sup>31</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c)

<p>(...)</p> <p>R400.14</p> <p>control of human, financial, technological, physical and intangible resources.</p> <p>When performing a professional activity for an audit client, the firm shall be satisfied that client management makes all judgments and decisions that are the proper responsibility of management. This includes ensuring that the client's management:</p> <p>(a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the activities. Such an individual, preferably within senior management, would understand:</p> <p>(i) The objectives, nature and results of the activities; and</p> <p>(ii) The respective client and firm or network firm responsibilities.</p> <p>However, the individual is not required to possess the expertise to perform or re-perform the activities.</p> <p>(b) Provides oversight of the activities and evaluates the adequacy of the results of the activities performed for the client's purpose.</p> <p>(c) Accepts responsibility for the actions, if any, to be</p>	<p>professional engagement period, the accountant provides the following non-audit services to an audit client</p> <p>(vi) Management functions. Acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.</p>
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taken arising from the results of the activities.	
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#### Commentary

41. Both frameworks prohibit the assumption of management responsibility/acting as management for an audit client. However, the approaches in the Code and in the SEC rules differ.
- The Code focuses on ensuring that the client's management is taking responsibility for those decisions relating to the services being provided that are properly the responsibility of management, and provides application material to help firms satisfy themselves that an audit client makes all management judgments and decisions. The Code also provides a description of what is involved in management responsibilities, including examples of specific activities that would be considered a management responsibility.<sup>32</sup>
  - In contrast, the SEC rules prohibit the provision of services which the SEC regards as being the proper function of management. The prohibition applies irrespective of any arrangements that might be in place to ensure that management takes responsibility for decisions relating to such services.
42. The SEC rules also prohibit:
- Acting as an employee of an audit client.
  - Activities such as acting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.
43. The Code prohibits<sup>33</sup> a partner or an employee of an audit firm from serving as a director or an officer of an audit client. However, the Code does permit personnel to be loaned to an audit client for a short period of time, provided certain conditions are met.<sup>34</sup>

#### *Non-Compliance with Laws and Regulations*

44. Although not part of the IIS, the Code establishes the public interest expectation for how accountants, including those engaged to perform audits of financial statements, should respond when they become aware of, or suspect, non-compliance with laws and regulations.<sup>35</sup> The Code requires professional accountants, including an auditor, to comply with legislation that governs how professional accountants address actual or suspected non-compliance with laws and regulations.<sup>36</sup> Such legal or regulatory provisions typically apply to offenses such as terrorism, drug dealing, money- laundering, and dealing with the proceeds of crime and require disclosure to a designated authority.
45. Auditors might encounter actual or suspected non-compliance with laws and regulations other than those referred to in paragraph 44. The Code contains requirements and provides guidance on the approach to be taken by professional accountants in such circumstances.
46. The Code's approach focuses on non-compliance with laws and regulations:

<sup>32</sup> See paragraphs R400.13 to R400.14 of the Code.

<sup>33</sup> Paragraph R523.3 of the Code

<sup>34</sup> Paragraph R525.4 of the Code

<sup>35</sup> Paragraphs R360.10 to 360.28 A1

<sup>36</sup> Paragraph R360.6 of the Code

- (a) That directly affect a client's financial statements; or
  - (b) Where non-compliance might threaten a client's activities and continued operations.<sup>37</sup>
47. In view of an auditor's responsibility to act in the public interest, the auditor's objectives are to comply with the fundamental principles of objectivity and professional behavior by alerting management or TCWG of the identified or suspected non-compliance so they can take action to rectify or mitigate the consequences of the non-compliance or prevent it from occurring, and to take such other action as might be appropriate.<sup>38</sup>
48. The Code provides that an auditor who encounters actual or suspected non-compliance should:
- Obtain an understanding of the relevant facts and circumstances.<sup>39</sup>
  - Discuss the matter with the appropriate level of management and, where appropriate, TCWG<sup>40</sup> and advise them to take appropriate and timely actions.<sup>41</sup>
  - Comply with applicable laws, regulations and professional standards.<sup>42</sup>
  - Assess the appropriateness of the response of management and TCWG.<sup>43</sup>
  - Determine whether further action is required in the public interest (including reporting the matter to an appropriate authority and/or withdrawing from the engagement),<sup>44</sup> including considering whether a reasonable and informed third party would conclude that the accountant had acted appropriately in the public interest.<sup>45</sup>
49. The Code provides that disclosure made in good faith to an appropriate authority is permitted and does not create a breach of the fundamental principles.<sup>46</sup>
50. The Code also contains guidance on the considerations an auditor might have regard to when reporting actual or suspected non-compliance with laws and regulations to an appropriate authority.<sup>47</sup>
51. The US Securities Exchange Act of 1934 requires<sup>48</sup> that an auditor, who in the course of conducting an audit, detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, to:
- Determine whether it is likely that an illegal act has occurred; and
  - If so, determine and consider the possible effect of the illegal act on the financial statements of the issuer.

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<sup>37</sup> Paragraph 360.3 of the Code

<sup>38</sup> Paragraph 360.4 of the Code

<sup>39</sup> Paragraph 360.10 of the Code

<sup>40</sup> Paragraph R360.11 of the Code

<sup>41</sup> Paragraph R360.13 of the Code

<sup>42</sup> Paragraph R360.15 of the Code

<sup>43</sup> Paragraph R360.19 of the Code

<sup>44</sup> Paragraphs R360.20 and 360.21 A1 of the Code

<sup>45</sup> Paragraph R360.21 of the Code

<sup>46</sup> Paragraph R360.26 of the Code

<sup>47</sup> Paragraphs 360.25 A1 to A3 of the Code

<sup>48</sup> Securities Exchange Act as of 1934, Section 10A



52. Although, neither the SEC nor the PCAOB independence rules address the steps that might be taken by an auditor on becoming aware that an illegal act has occurred or is occurring, the Securities Exchange Act and the PCAOB auditing standards both include general requirements on the auditor's responsibility regarding illegal acts. Among other things, the PCAOB auditing standards address the auditors' responsibilities to detect and to report misstatements resulting from illegal acts with a direct and material effect on the financial statements and further require an auditor to be aware of the possibility that other illegal acts may have occurred that could have a material indirect effect on the financial statements. If specific information comes to the auditor's attention that provides evidence of the existence of possible illegal acts, the auditor is required to apply audit procedures specifically directed to ascertaining whether an illegal act has occurred and its potential effect on the financial statements.<sup>49</sup>

#### Commentary

53. The issue of non-compliance with laws and regulations is addressed in the Code but is not addressed explicitly in the SEC or PCAOB independence rules.
- The Code's provisions apply to all professional accountants, including auditors, and provide guidance on how to address the position if the actual or suspected breach of law or regulation is of such significance as to require action in the public interest. If the breach becomes known in the course of an audit, an auditor is required to comply with applicable auditing standards.
  - The Security Exchange Act of 1934 and PCAOB auditing standards address the auditor's responsibility with respect to illegal acts focusing mainly on their effect on the financial statements.

### III. Key Definitions

54. A comparison of the key definitions is central to any benchmarking of the Code to the SEC/ PCAOB rules, as substantive differences in those key definitions can materially affect the ambit and efficacy of the frameworks' substantive provisions. Therefore, the conclusions regarding the main similarities and differences in the Commentary paragraphs in this Report should be read in conjunction with this section.

#### A. Audit Client and Related Entities/ Affiliates

##### *Audit Client*

55. In the Code, the term 'audit client' is defined as an entity and its related entities in respect of which a firm conducts an audit engagement, and the IIS apply to all firms and professional accountants undertaking such audit engagements.
56. The Code contains supplementary provisions that are applicable to audits of PIEs. A PIE is defined in the Code<sup>50</sup> as:
- (a) A listed entity; or
  - (b) An entity:
    - (i) Defined by regulation or legislation as a PIE; or

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<sup>49</sup> PCAOB AS 2405, paragraphs 5-7

<sup>50</sup> As noted above, the IESBA unanimously approved revisions to the Code's definition of a PIE in December 2021 that will become effective in December 2024.

- (ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation might be promulgated by any relevant regulator, including an audit regulator.<sup>51</sup>
57. In the context of the SEC rules, “audit client” means the entity whose financial statements or other information is being audited, reviewed, or attested to and any affiliates of the audit client.<sup>52</sup>
58. The SEC/PCAOB rules apply to accounting firms and professional accountants that audit financial statements of ‘issuers’ among other entities.

#### Commentary

59. For purposes of this Report, which focuses on the relationship between an auditor and an audit client, the terms ‘professional accountant’, ‘accountant’ and ‘auditor’ are regarded as equivalent.
60. The term ‘issuer’ (used in the SEC rules) and ‘listed entity’ (used in the PIE definition in the Code) are also regarded as equivalent.
61. Although the Code applies to a wider group of entities than the SEC rules – by virtue of subparagraph (b) of the PIE definition - this Report compares the provisions of the Code that are relevant to auditors of PIEs with the requirements of the SEC rules.

#### Related Entities/ Affiliates

62. Under the Code, in the case of PIEs that are listed entities, the definition of an audit client includes the “related entities of that PIE.” For all other entities, including for PIEs audit clients that are not listed, the definition of related entities differs. that are included in the definition of a PIE audit client that is a listed entity differ from the related entities if the audit client is an unlisted PIE.<sup>53</sup>
63. Under the SEC rules, the definition of an audit client includes all “affiliates.”
64. It is therefore necessary to compare the definitions of “related entities” in the Code with the definition of “affiliates” under the SEC rules to determine whether the application of the Code and the SEC rules to other entities within a group is equivalent in scope.
65. The table below compares the description of related entities under the Code and the description of affiliates under the SEC rules:

Code – Related Entities	SEC – Affiliates <sup>54</sup>
(a) An entity that has direct or indirect control over the client if the client is material to such entity;	(i) An entity that has control over the entity under audit, or over which the entity under audit has control, including the entity under audit’s parents and subsidiaries;
(b) An entity with a direct financial interest in	(iv) An entity that has significant influence over

<sup>51</sup> Please refer to the Glossary of the Code

<sup>52</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01(f) (6)

<sup>53</sup> Paragraph R400.20 of the Code provides that an audit client that is a listed entity includes all of its related entities. For all other entities, references to an audit client in [Part 4A of the Code] include related entities over which the client has direct or indirect control. When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm’s independence from the client, the audit team shall include that related entity when identifying, evaluating and addressing threats to independence

<sup>54</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01(f) (4)

Code – Related Entities	SEC – Affiliates <sup>54</sup>
the client if that entity has significant influence over the client and the interest in the client is material to such entity;	the audit client, unless the audit client is not material to the entity; or
(c) An entity over which the client has direct or indirect control;	See point (i)
(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and	(iii) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;
(e) An entity which is under common control with the client (a “sister entity”) if the sister entity and the client are both material to the entity that controls both the client and sister entity.	(ii) An entity that is under common control with the entity under audit, including the entity under audit’s parents and subsidiaries, when the entity and the entity under audit are each material to the controlling entity;
	(v) Each entity in the investment company complex as determined in paragraph (f)(14) of this section when the entity under audit is an investment company or investment adviser or sponsor, as those terms are defined in paragraphs (f)(14)(ii), (iii), and (iv) of this section.

66. The SEC rules also use the term “the entity under audit” in the definition of an “affiliate of the audit client” (see paragraph 65), in the prohibition of loans/debtor-creditor relationships in certain circumstances regarding beneficial owners (see paragraphs 262 and 265) and in the prohibition of “business relationships” (see paragraphs 277 and 280). Where that term is used in a specific section of the rule, it applies to the entity being audited only and does not apply to any entities that would otherwise be “affiliates” under the definition of an audit client (see paragraph 63 above).

#### Commentary

67. There are two notable differences in the definitions in the two frameworks:
- The Code excludes entities that control an audit client if the audit client is immaterial to the controlling entity; whereas the SEC rules include them; and
  - The Code includes relationships that result in significant influence only if that influence arises from a direct financial interest;<sup>55</sup> the SEC rules apply irrespective of how that significant influence arises.<sup>56</sup>

In both instances, the differences result in the SEC rules having a wider application.

<sup>55</sup> See point (b) and (d) of the definition of related entities in the Glossary of the Code

<sup>56</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (4) point (iii) and (iv)

*\*\*As of March 3, 2022 \*\**

68. The SEC rules define investment company complexes<sup>57</sup> and address which companies are included within an investment company complex and which are, therefore, considered affiliates of an audit client. The Code does not include specific provisions for investment company complexes.

## **B. Network Firms/ Associated Entities**

69. Under the Code, firms and network firms are both required to be independent of their audit clients and the Code specifically states whether a specific provision applies not only to an audit firm, but also to any network firm.<sup>58</sup>
70. The SEC rules do not address specifically the position of network firms. However, the definition of an "accounting firm" includes<sup>59</sup> the accounting firm's "associated entities" and therefore the independence rules applicable to an accounting firm also apply to its "associated entities". In interpreting the rule, the SEC has regard to all the relevant facts and circumstances.<sup>60</sup>

### **Commentary**

71. As the SEC Staff's practice is to have regard to all the relevant facts and circumstances when applying its definition of an "accounting firm", it is not possible to provide a definitive list of those entities that the SEC would regard as being within the definition of an accounting firm. References in this Report to an accountant or 'accounting firm' include 'associated entities'.
72. Both frameworks appear to have a comparable objective – namely to address the position of those firms which are required to be independent of an audit client. However, practice in the US might extend the application of the SEC practice to entities that might not be regarded as network firms under the Code. For example, as a matter of practice, accounting firms [frequently/usually] regard entities in which they hold a 20 percent or more interest or over which they exercise significant influence as associated entities.

## **C. Audit Team<sup>61</sup>**

73. The Code defines an "audit team" as:
- All members of the engagement team for the audit engagement,
  - All others within a firm who can directly influence the outcome of the audit engagement,
  - All those within a network firm who can directly influence the outcome of the audit engagement.<sup>62</sup>
74. The SEC rules define the "audit engagement team" as:

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<sup>57</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01(f)(14)

<sup>58</sup> Paragraphs 400.50 A1 to 400.54 A1 of the Code

<sup>59</sup> Based on SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (f) (2) an "accounting firm" "includes all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States. An "accounting firm" also includes the organization's pension, retirement, investment, or similar plans.

<sup>60</sup> SEC, Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, [K. Definitions](#), Question 1

<sup>61</sup> In December 2021, the IESBA approved an Engagement Team – Group Audits Independence Exposure Draft (ED) which among others, including proposed revisions to the Code's definition of "engagement team" and the related terms "audit team," "assurance team" and "review team" as a result of changes to the definition of "engagement team" in the IAASB's Quality Management standards. [The ED is available on the [IESBA's website](#) and the comment deadline is May 31, 2022.

<sup>62</sup> Refer to the Code's Glossary definition of "audit team."

*“All partners, principals, shareholders and professional employees participating in an audit, review, or attestation engagement of an audit client, including audit partners and all persons who consult with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events”.<sup>63</sup>*

75. When comparing the provisions of the Code and the SEC rules, it is relevant to note that the Code generally focuses on the audit team as the base, while the corresponding SEC rules apply to “covered persons” as well as to the members of the audit team (as defined). The term “covered persons”<sup>64</sup> includes the partners, principals, shareholders, and employees of an accounting firm who form part of
- The “audit engagement team;”
  - The “chain of command;” and
  - Other partners, principals, shareholders, and managerial employees meeting the test set out in paragraph 76 below.

#### Commentary

76. The Code’s provisions apply to different individuals depending on the topic/area of the relationship. Where the Code’s provisions are relevant to the audit team only, the SEC rules are broader as the SEC rules apply to individuals who are not addressed in the Code’s audit team definition, namely:
- Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of non-audit services to the audit client in the relevant time period, and
  - Any other partner, principal, or shareholder from an “office” of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.
77. However, in the case of the prohibition on holding financial interests in the audit client, the Code adopts a similar approach to the SEC rules, and includes other partners and managerial employees<sup>65</sup> in the firm as persons to whom that prohibition applies.

## D. Key Audit Partner/ Audit Partner

78. The Code<sup>66</sup> and the SEC rules<sup>67</sup> adopt the same approach when defining a “key audit partner” (in the Code) and an “audit partner” (in the SEC rules). Both frameworks include the same categories of individuals, namely (a) the engagement partner/lead partner (b) the engagement quality reviewer (EQR), and (c) other audit partners who make key decisions or judgments on significant matters with respect to the audit.

#### Commentary

79. Although both frameworks adopt the same categories, the individuals falling within the category of ‘other audit partners (category (c) in paragraph 78) differ because the categories the SEC definition also includes:

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<sup>63</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (7) (i)

<sup>64</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (11)

<sup>65</sup> Paragraph R510.4 (c)-(d) of the Code

<sup>66</sup> Please refer to the Glossary to the Code

<sup>67</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (f) (7) (ii)

- Other partners on the engagement team who maintain regular contact with management and the audit committee; and
- Other audit engagement team partners who provide more than ten hours of audit, review, or attest services in connection with the annual or interim consolidated financial statements of the issuer or an investment company.

## IV. Focus Areas and Topics

### A. Fee-related Provisions<sup>68</sup>

#### *Fees paid by an audit client and Total Fees*

80. The 2021 fee-related revisions introduced new provisions to the IIS to address the threats to independence related to the audit payer model.<sup>69</sup> The Code approaches the issue of fees from the perspective that an inherent self-interest threat is created by the fact that audit fees are paid to an audit firm by an audit client.
81. The Code does not seek to determine the level of fees that might be appropriate.<sup>70</sup> Although the Code recognizes that the determination of audit fees is a business decision taking into account the facts and circumstances (including the requirements of professional and technical standards),<sup>71</sup> it emphasizes that the audit fee should be set on a standalone basis without regard to the level of fees for other services provided to an audit client.<sup>72</sup>
82. Apart from level of fees, the Code explicitly addresses and includes requirements regarding the threats that might arise from the total amount of fees, including audit and other fees, paid by an audit client - such as the proportion of fees received from an audit client and a firm's dependency on fees received from an audit client.
83. While the Code does not include any specific threshold or prohibition regarding the proportion of audit fees to non-audit fees, it does provide guidance on the evaluation of the level of threats created where a firm or network firm receives a large proportion of fees for the provision of services other than audit.<sup>73</sup>
84. The Code provides guidance on the evaluation of the threats arising from fee-dependency at the firm, office or partner level.<sup>74</sup> Furthermore, if fees received from an audit client exceed 15 percent of the total fees of the firm, the Code requires the firm to determine – in line with the application of the conceptual framework – whether specific safeguards (such as a pre or post-issuance review by an external reviewer) could reduce the level of the threats to an acceptable level<sup>75</sup>. If this level of fee-dependency continues for more than five consecutive years, the Code requires

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<sup>68</sup> This section refers to the [Final Pronouncement: Revisions to the Fee-related Provisions of the Code](#) that will become effective in December 2022.

<sup>69</sup> Revised paragraph 410.3 A1 of the Code

<sup>70</sup> Revised paragraphs 410.4 A1 to 410.4 A5 of the Code

<sup>71</sup> Revised paragraph 410.5 A1 of the Code

<sup>72</sup> Revised paragraphs R410.6 to R410.7 of the Code

<sup>73</sup> Revised paragraphs 410.11 A1 to 410.11 A3 of the Code

<sup>74</sup> Revised paragraphs 410.14 to 410.14 A7 of the Code

<sup>75</sup> Revised paragraph R410.18 of the Code

the firm to cease to be the auditor and end the audit engagement after the audit opinion for the fifth year is issued.<sup>76</sup>

85. Complementing the specific provisions above, the 2021 fee-related revisions of the Code included new and enhanced requirements regarding disclosure of fee-related information to TCWG and the public. (See paragraphs 100-101 below)
86. The SEC and PCAOB do not have any specific rules to address any issues that might arise from the level of fees and the total amount of fees paid to the audit firm by the audit client. However, the SEC rules do require transparency of such fee-related information in the audit client's proxy statement (see paragraph 102 below).

#### Commentary

87. While the Code includes detailed guidance and requirements in relation to the level of fees, the total amount of fees, and fee-dependency, the SEC and PCAOB ethics and independence rules do not address these issues. However, the SEC's general independence standard and the overarching principles still apply.

#### Contingent Fees

##### Description

88. The Code defines contingent fees as fees that are calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed.<sup>77</sup> A contingent fee charged through an intermediary is an example of an indirect contingent fee. A fee is not regarded as being contingent if established by a court or other public authority.
89. According to SEC rules, contingent fees are fees established for the sale of a product or the performance of any service pursuant to an arrangement under which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service. Under SEC's independence rules a fee is not a "contingent fee" if it is fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.<sup>78</sup>
90. Although the analogous PCAOB rule<sup>79</sup> and related definition of "contingent fee"<sup>80</sup> are modeled on the SEC's independence rules, the PCAOB rules differ in certain respects, and do not include the SEC's exception for fees in tax matters if determined based on the results of judicial proceedings or the findings of government agencies.

##### Prohibitions

91. The Code expressly prohibits firms from charging, directly or indirectly, a contingent fee for an

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<sup>76</sup> Revised paragraph R410.21 provides an exception to this requirement, provided that specified conditions are met. That condition would apply if there is a compelling reason and the relevant profession or regulatory body concludes that it would be in the public interest if the firm continues the engagement.

<sup>77</sup> Revised paragraph 410.8 A1 of the Code

<sup>78</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (f) (10)

<sup>79</sup> Rule 3521. - Contingent Fees

<sup>80</sup> Rule 3501. Definitions of Terms Employed in Section 3, Part 5 of the Rules (c) (ii)



*\*\*As of March 3, 2022 \*\**

audit engagement<sup>81</sup> or other assurance engagement.<sup>82</sup> The Code also prohibits firms (or network firms) from charging, directly or indirectly, a contingent fee for a NAS provided to an audit client if:

- The fee is material or expected to be material to the firm expressing the opinion on the financial statements;
- The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or
- The outcome of the NAS, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements.<sup>83</sup>

92. The SEC rules state that an accountant is not independent if, at any point during an audit or professional engagement period, it provides a service or product to an audit client for a contingent fee or a commission, or receives a contingent fee or commission from an audit client.<sup>84</sup> In addition, the PCAOB rules provide that a firm is not independent of an audit client if it receives a contingent fee or commission from that client "directly or indirectly."<sup>85</sup>

#### Commentary

93. Both frameworks prohibit firms from charging contingent fees for any audit or other assurance engagements.
94. While the SEC rules also prohibit an accountant from charging a contingent fee for any other service or product provided to an audit client, the Code:
- Prohibits charging contingent fees for a NAS provided to an audit client only if that fee is material;<sup>86</sup>
  - Require firms to apply the conceptual framework to identify, evaluate and address threats to independence that might be created by charging contingent fees for the provision of a NAS to an audit client.
95. In addition, the SEC rules restrict accountants from providing services or products to an audit client for a commission. In contrast, the Code does not include a general prohibition on receiving

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<sup>81</sup> Revised paragraph R410.9 of the Code

<sup>82</sup> Paragraph 905.7 of the Code

<sup>83</sup> Revised paragraph R410.10 of the Code

<sup>84</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (5)

<sup>85</sup> The PCAOB rule's use of the term "indirectly" is meant to prevent arrangements for a fee from any person that is contingent on a finding or result attained by the audit client. The Board's determination to include such fees within the prohibition is based on the principle that, regardless of who pays the contingent fee, such a contingency gives an auditor a stake in the audit client attaining the finding or result.

Accordingly, under Rule 3521, it does not matter who pays the contingent fee, if it is contingent on a finding or result attained by the audit client or otherwise related to the firm's services for the audit client. That is, while use of an intermediary to disguise an audit client's agreement to a contingent fee is certainly prohibited, the rule is not limited to circumstances in which a contingent fee may be traced (e.g., through an intermediary) to an agreement or payment by an audit client.

<sup>86</sup> Paragraph 144 of the [Basis for Conclusions](#), *Revisions of Fee-related Provisions of the Code*, notes that:

- The changes arising from the NAS project (in particular the self-review threat prohibition) will significantly limit the extent of permissible NAS a firm could provide, especially to a PIE audit client.
- If the provision of a NAS is not prohibited by the revised NAS provisions and the contingent fee does not meet any criteria that would result in a prohibition according to paragraph R410.10, the conceptual framework will apply in addressing the self-interest threat created.

such commissions unless the criteria of a contingent fee are also met. However, the Code identifies that a self-interest threat to compliance with the principles of objectivity and professional competence and due care is created if the firm receives a commission relating to a client and requires the firm to apply the conceptual framework to reduce the level of such threat to an acceptable level.<sup>87</sup>

#### *Overdue Fees*

96. The Code recognizes that firms generally obtain payment of fees for audit or services other than audit before an audit report is issued.<sup>88</sup> If a significant part of the fees due from an audit client remains unpaid for a long time, the Code requires the firm to determine
- Whether the overdue fees might be equivalent to a loan to the client, in which case the provisions of the Code governing loans to clients are applicable; and
  - Whether it is appropriate for the firm to be re-appointed or continue the audit engagement.<sup>89</sup>
97. The SEC independence rules and releases do not specifically address overdue fees. However,
- In its response to a FAQ,<sup>90</sup> the SEC Staff stated that “generally, prior year audit and other unpaid professional fees should be paid before a current audit engagement is commenced in order for the accountant to be deemed independent with respect to the current audit. However, normally a question would not be raised in such situations if, at the time the current audit engagement is commenced, a definite commitment is made by the client to pay the prior professional fees before the current year audit report is issued, or an arrangement is agreed upon for periodic payments to settle the delinquent fees and there is reasonable assurance that the current audit fee will be paid before the audit of the ensuing year begins. But, if audit and other professional services fees are owed to an accountant for an extended period of time and become material in relation to the fee expected to be charged for a current audit, there may be a question concerning the accountant’s independence with regard to the current audit because the accountant may appear to have a direct interest in the results of operations of the client.”
  - The PCAOB Interim Ethics and Independence Standards<sup>91</sup> states that auditor independence is considered to be impaired if, when the report on the client's current year is issued, billed or unbilled fees, or a note receivable arising from such fees, remain unpaid for any professional services provided more than one year prior to the date of the report. This ruling does not apply to fees outstanding from a client in bankruptcy.

#### *Commentary*

98. Both the Code and the SEC rules recognize that fees for audit and other services provided to the audit client that remain unpaid, and are material, could impact the firm’s independence, and require a firm to assess the position and take appropriate action.
99. In contrast to the Code, the PCAOB rules

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<sup>87</sup> Paragraph 330.5 A1 of the Code

<sup>88</sup> Revised paragraph 410.12 A2 of the Code

<sup>89</sup> Revised paragraph R410.13 of the Code

<sup>90</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, [A- General Standards of Independence](#), Question 2

<sup>91</sup> PCAOB Interim Ethics and Independence Standard ET Section 191.103-104, *Unpaid Fees*

- Include no materiality threshold, and
- Specify that a firm's independence is considered to be impaired if the fees remain unpaid more than one year prior to the date of the report issues.

#### *Transparency of Fee-related Information*

100. The IESBA recognizes that transparency of fee-related information, including public disclosure, contributes to confidence in auditor independence. In some jurisdictions, national laws and regulations specify the information to be provided. Where no such laws or regulations exist, disclosure of fee-related information is the responsibility of the client management.<sup>92</sup> To address those circumstances, the Code requires audit firms to discuss the benefits to the client's stakeholders of the client making such disclosures.<sup>93</sup>
101. If the fee-related information is not disclosed by the client, the Code requires the firm to make information about audit fees, fees for services other than audit, and fee-dependency publicly available. The Code does not prescribe how that is to be achieved – it allows a flexible approach recognizing that a firm will need to have regard to applicable laws and regulation.<sup>94</sup>
102. The SEC requires an issuer to disclose in its proxy statement or appropriate filing forms the aggregate fees billed for each of the last two fiscal years, grouped as audit fees, audit-related fees, tax fees and other fees paid by the audit client to the principal accountant.<sup>95</sup>

#### *Commentary*

103. Both the IESBA and the SEC attach importance to the public disclosure of information about fees paid to auditors for audit and other services.
104. However, given their different remits, the Code and the SEC rules establish different ways to achieve public disclosure. As a national regulator, the SEC has authority to establish requirements for the disclosure of fees by the audit client. In contrast, as the IESBA does not have legislative or regulatory authority in those jurisdictions that adopt the Code, the Code can only require a firm
- a) To promote the disclosure of fee-related information by an audit client, and
  - b) To disclose that information in such manner as might be deemed appropriate if an audit client refuses to disclose that information.

## **B. Non-Assurance (NAS)/ Non-Audit Services – General Provisions<sup>96</sup>**

*This report focuses on the Code's NAS provisions that apply to audits of PIEs. The Code's NAS provisions are set out under subheadings titled "General" and "All Audit Clients" together with additional specific provisions that, including those set out under the subheadings titled "Audit Clients that are not Public Interest Entities" or "Audit Clients that are Public Interest Entities." Complying with the Code's NAS provisions for audits of financial statements, requires knowing, understanding, and*

<sup>92</sup> [Basis for Conclusions](#), *Revisions to Fee-related Provisions of the Code*

<sup>93</sup> Revised paragraph R410.30 of the Code

<sup>94</sup> Revised paragraphs R410.31 to R410.32 of the Code

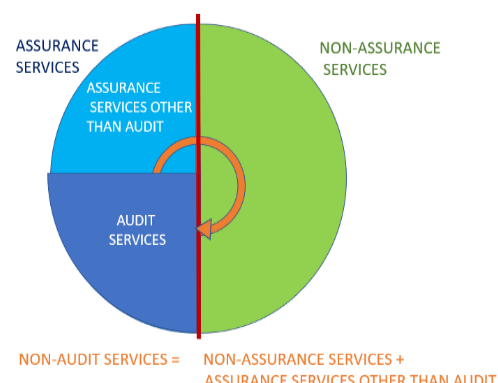
<sup>95</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 240.14a-101 Schedule 14A. Information required in proxy statement – Item 9

<sup>96</sup> This section includes the [Final Pronouncement: Revisions to the Non-Assurance Services Provisions of the Code](#) that will become effective in December 2022.

applying the provisions in Section 600, together with the other relevant provisions in other parts and sections of the Code (e.g., Section 120, 300 and 400).

105. The Code and the SEC rules have the same overarching objective, namely, to ensure that the provision of additional services to audit clients does not compromise an audit firm's independence. In both frameworks, the approach taken is similar, in that both frameworks rely on strong overarching principles, complemented by a list of specific prohibited services.

PROFESSIONAL SERVICES OFFERED TO AN AUDIT CLIENT



106. Although the conceptual approach adopted by the two frameworks is similar, it is noteworthy that the Code has two sets of non-assurance services sections<sup>97</sup> (i.e., one set applies in the case of audit and review engagements, and the other applies to assurance engagements other than audit and review engagements). Firms that provide a non-assurance service to an audit client are required to comply with the fundamental principles, the conceptual framework and the other relevant provisions of the Code. The SEC rules<sup>98</sup> identify specific services that accountants are prohibited from providing to audit clients. All other services are subject to the SEC general standard and overarching principles.

107. This section compares the overarching principles relevant to the provision of non-audit/non-assurance services to an audit client. Section IV, C of this Report compares the specific NAS/ non-audit services that are prohibited under each framework. The role of TCWG in relation to the provision of NAS/ non-audit services to an audit client is considered in Section IV, D below.

#### *Overarching Principles Relevant to the Provision of NAS/ Non-Audit Services to an Audit Client*

108. Under the Code, when a firm is determining whether to provide a NAS to a PIE audit client, the firm, among others, first considers:

- Whether the NAS is specifically prohibited under the Code.
- The laws and regulations in the specific jurisdiction relating to the provision of NAS.<sup>99</sup>
- Whether the provision will result in the firm assuming management responsibility.<sup>100</sup>
- Whether the provision of that service might create a self-review threat in relation to the audit of the financial statements on which the firm will express an opinion.<sup>101</sup>
- Whether any other threats identified (self-interest, familiarity, advocacy and/or intimidation) are at an acceptable level.<sup>102</sup>

<sup>97</sup> The NAS provisions that apply to audit engagement are set out in revised Section 600 of the Code. The provisions in the IIS apply to both audit and review engagements. The terms "audit," "audit team," "audit engagement," "audit client," and "audit report" apply equally to review, review team, review engagement, review client, and review engagement report (see paragraph 400.2 of the Code).

<sup>98</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4)

<sup>99</sup> Revised paragraph 600.6 A1 of the Code

<sup>100</sup> Revised paragraphs 600.7 A1 and R400.14 of the Code

<sup>101</sup> Revised paragraph R600.8 of the Code

<sup>102</sup> Revised paragraph R600.14 of the Code

109. The SEC's approach with respect to services provided by auditors is largely founded on the Commission's overarching principles that are described in Section II, B and C above, violations of which would impair the auditor's independence.

*Commentary*

110. The Code and the SEC rules are based on the application of the fundamental principles/overarching principles to the provision of NAS/ non-audit services to audit clients. Those principles are required to be complied with when firms provide services that are not mentioned specifically in the respective standards to audit clients.
111. As the Code is applicable at a global level and its application is subject to the national laws and regulations in each jurisdiction, the Code also requires consideration of whether national laws and regulations differ from or go beyond the Code's provisions.

*Management Responsibility*

112. The approaches taken to the assumption of management responsibility in the Code and the SEC rules are considered in Section II, C above.

*Prohibition on NAS that Might Create Self-review Threats*

113. Under both frameworks, the risk of the auditor being placed in a position of auditing his/her own work is a key consideration when determining whether an auditor can provide a specific service to an audit client.<sup>103</sup>
114. The revised NAS provisions to the Code introduced a new, overarching requirement that prohibits firms from providing a NAS to a PIE audit client if the provision of that service might create a self-review threat in relation to the audit of the financial statements on which the firm will express an opinion.
115. The use of "*might create*" in the Code's provision means that the provision of a NAS is prohibited once a firm identifies a risk that a self-review threat might be created – as opposed to when that firm concludes that a self-review threat will in fact be created - and is intended to reduce the risk that a firm might incorrectly conclude (a) that a proposed NAS will not create a self-review threat, or (b) that the outcome of the proposed NAS will not be subject to audit procedures.
116. The Code does not include any specific prohibitions that apply where a firm provides assurance services to an audit client. In such situations, the Code requires the firm to apply the conceptual framework to identify, evaluate and address any threats to independence that might arise as a result of the proposed assurance service.
117. In line with the Code's overarching principles, the related SEC principles and specific rules contain an absolute prohibition against accountants providing services to an audit client if that service places them in the position of auditing their own work.

*Commentary*

118. In practice, the approach of the two frameworks is the same. Under the IESBA Code any situation where a self-review threat might exist is prohibited for PIE audit clients. For entities subject to the SEC rules there is an overarching principle that an auditor cannot be in a position (or be perceived to be in a position) of auditing his/her own work.

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<sup>103</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 Introductory note and requirement in paragraph R600.16 of the Code

*The Risk of Self-review Arising from the Provision of Advice and Recommendations*

119. The Code acknowledges that provision of advice and recommendations might create a self-review threat. This is the case whether that advice and recommendation is provided as a separate engagement, or in the course of providing a specific NAS. Therefore, generally, the provision of advice and recommendations to a PIE audit client that might create a self-review threat is prohibited. As an exception to the application of the self-review threat prohibition, the Code allows for the provision of advice and recommendations if that advice and recommendations relates to information or matters arising in the course of an audit, provided that the firm:<sup>104</sup>
- Does not involve the assume a management responsibility, and
  - Applies the conceptual framework to identify, evaluate and address any other threats, other than self-review threats, to independence that might be created by the provision of that advice.
120. The SEC rules does not specifically address the provision of advice and recommendations in general. However, in addition to assessing the appropriateness of the service having regard to the overarching principles, the accountant would be expected to consider all available SEC guidance (see paragraph 109 above). That would include, for example, an SEC release that recognizes that “obtaining an understanding of, assessing effectiveness of, and recommending improvements to the internal accounting and risk management controls is fundamental to the audit process and does not impair the accountant’s independence”<sup>105</sup> (emphasis added). See also paragraph 188 and the relevant commentary to that section.

Commentary

121. As an exception to the general self-review threat prohibition, the Code permits the provision of advice and recommendations relating to information or matters arising in the course of an audit. The SEC rules do not specifically prohibit providing advice and recommendation, and SEC guidance and releases include examples of specific situations where providing advice and recommendation to an audit client does not impair the accountant’s independence.

*Non-assurance services/ non-audit services that might create threats other than self-review*

122. Although the Code’s provisions applicable to PIE audit clients and the SEC rules have a similar approach in relation to the provision of NAS/non-audit services to an audit client in the case of NAS that might give rise to threats other than self-review, the framework of the SEC rules could appear to be more restrictive (see paragraph 33 of this Report). However, in all circumstances, firms are required to avoid assuming a management responsibility for an audit client, and apply the conceptual framework to identify, evaluate and address threat, other than self-review threats, to independence.
123. The revised NAS provisions provide greater clarity on the circumstances in which a firm may provide a NAS that might create an advocacy threat to independence. Generally, in the case of audit clients that are PIEs, acting as an expert witness is prohibited. Although the Code might appear to be more permissive than the SEC rules, in the IESBA’s view,<sup>106</sup> the combination of the general self-review threat prohibition and the additional prohibitions on the provision of certain

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<sup>104</sup> See revised paragraphs 400.13 A4, 600.11 A1 and R600.17 of the Code.

<sup>105</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission’s Requirements Regarding Auditor Independence*, Section II B 5.

<sup>106</sup> [Basis for Conclusions, Revisions to Non-Assurance Service Provisions in the Code](#)

types of NAS that create an advocacy threat will substantively reduce the types of NAS that a firm may provide to an audit client that is a PIE having applied appropriate safeguards to reduce such threats to an acceptable level.

### *Consideration of Materiality*

124. Under the revised NAS provisions the self-review threat prohibition applies regardless of the materiality of the outcome or results of the NAS on the financial statements on which the firm will express an opinion.<sup>107</sup>
125. The SEC rules take the same approach to the relevance of materiality. In its response to a frequently asked question (FAQ) <sup>108</sup> the SEC Staff stated that *“materiality is not a 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.”

### *Provision of Services to Certain Related Entities*

126. Under the Code,<sup>109</sup> a firm or a network firm may provide a NAS that would otherwise be prohibited to the following related entities of an audit client provided that specified conditions are satisfied including, in particular, that the NAS does not create a self-review threat:
- An entity that has direct or indirect control over the client (i.e., parent entity);
  - An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; or
  - An entity which is under common control with the client (i.e., a sister entity).
127. The SEC rules provide that the provision of “five specific services” (bookkeeping or other services related to the accounting records or financial statements of the audit client, financial information systems design and implementation, appraisal or valuation services, fairness opinions, or contribution-in-kind reports, actuarial services, internal audit outsourcing) causes the auditor to lack independence, *“unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client’s financial statements”* (the “not subject to audit” exception).<sup>110</sup>
128. The SEC rules do not explicitly exclude certain affiliates of audit clients from the scope of the restrictions of the provision of non-audit services to an audit client.<sup>111</sup> However, the SEC has recognized that an example of a situation where it would be reasonable to conclude that the results of a specific service would not be subject to audit procedures would be where an accountant provides a prohibited service to an affiliate of the audit client, but the accountant is not the auditor of the entity or entities that control the audit client or its affiliate.<sup>112</sup>

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<sup>107</sup> Revised paragraph 600.10 A2 of the Code

<sup>108</sup> Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence – Frequently Asked Questions, E - Non-audit Services [Question 3](#)

<sup>109</sup> See revised paragraph R600.26 of the Code.

<sup>110</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (i) – (v)

<sup>111</sup> In addition, PCAOB rules generally do not explicitly exclude affiliates of audit clients from the scope of the restrictions of the provision of non-audit services to an audit client (or its personnel) either. But see PCAOB Rule 3523 which includes exceptions based on materiality and if a service is provided to an affiliate of the audit client that is audited by another firm.

<sup>112</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission’s Requirements Regarding Auditor Independence*, Footnote 51



\*\*As of March 3, 2022 \*\*

129. Further, as part of an FAQ, the SEC Staff<sup>113</sup> noted that if separate entities under common control have autonomous financial and business operations, and the audit firm audits one of the entities, that audit firm might be able to apply the “not subject to audit” exception to entities that it does not audit. In that context, the SEC staff has not objected to the “not subject to audit” exception being applied in a private equity group context under similar circumstances. However, the SEC Staff added that the “not subject to audit” exception might not apply in other contexts, such as a traditional corporate entity or an investment company complex, depending on the particular facts and circumstances.
130. As the “not subject to audit” exception applies only to the “five specific services” listed in paragraph 127, the other non-audit services specifically addressed in the SEC<sup>114</sup> rules (management functions, human resources services, legal services, expert services unrelated to audit, , broker-dealer, investment adviser, or investment banking services) may not be provided to the affiliates of an audit client.

IESBA Code	SEC/PCAOB Rules
<p>Any NAS may be provided to certain related entities (see paragraph 126) provided that the NAS does not create a self-review threat to independence and the following specified conditions are met:</p> <ul style="list-style-type: none"> <li>• The firm does not express an opinion on the related entity.</li> <li>• The firm does not assume a management responsibility, directly or indirectly, for the entity on whose financial statements the firm will express an opinion.</li> <li>• The firm addresses other threats to independence created that are not at an acceptable level.</li> </ul> <p>Exception <b>does not</b> apply to entities that are controlled by the audited entity (i.e., downstream entities)</p>	<p>Only the following specified services may be provided to affiliates when it is <i>reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements</i>.</p> <ul style="list-style-type: none"> <li>• Bookkeeping or other services related to the accounting records or financial statements of the audit client</li> <li>• Financial information systems design and implementation</li> <li>• Appraisal or valuation services,</li> <li>• Fairness opinions, or contribution-in-kind reports</li> <li>• Actuarial services</li> <li>• Internal audit outsourcing service.</li> </ul> <p>Exception <b>does not</b> apply to entities that are controlled by the audited entity (i.e., downstream entities)</p>

#### Commentary

131. Both frameworks include exceptions that allow for the provision of NAS/non-audit services to certain related entities/affiliates when such services will not be subject to audit procedures (or in the case of the Code do not create a self-review threat). The specified conditions that must be met for these exceptions to apply are different. As summarized at the table above, in the case of

<sup>113</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, E. Non-Audit Service [Question 5](#)

<sup>114</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (vi) – (X)

the Code, the exception relates to any NAS, while the exception under the SEC/PCAOB framework relates only to specified types of non-audit services.

132. However, while the exception under the Code applies for all types of prohibited NAS, the SEC's "not subject to audit exception" is limited to only "five specific prohibited services" (i.e., bookkeeping or other services related to the accounting records or financial statements of the audit client, financial information systems design and implementation, appraisal or valuation services, fairness opinions, or contribution-in-kind reports, actuarial services, internal audit outsourcing).

## **C. Non-Assurance/ Non-Audit Services – Specific Provisions<sup>115,116</sup>**

### **Accounting and Bookkeeping Services**

#### *Overall approach*

133. Both the Code and the SEC rules generally prohibit the provision of accounting and bookkeeping services by a firm to an audit client. Those prohibitions are based on the fact that provision of such services would place the firm in a position of auditing its own work and the provision of the service would impair the auditor's independence.

#### *Exception to Prepare Statutory Financial Statements for a Related Entity/Affiliate*

134. As an exception to the general prohibition, the Code allows a firm to prepare the statutory financial statements for controlled related entities of an audit client<sup>117</sup> provided that:
- The audit report on the group financial statements of the public interest entity has been issued;
  - The firm does not assume management responsibility and applies the conceptual framework to identify, evaluate and address threats to independence;
  - The firm does not prepare the accounting records underlying the statutory financial statements of the related entity and those financial statements are based on client approved information; and
  - The statutory financial statements of the related entity will not form the basis of future group financial statements of that public interest entity.<sup>118</sup>
135. The SEC adopts a similar approach where accountants are asked to prepare statutory financial statements for companies provided those financial statements are not filed with the Commission.<sup>119</sup> The SEC's release stated<sup>120</sup> that "an accountant's independence would be

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<sup>115</sup> For this section of the Report, a Commentary discussion is provided for only certain types of services (i.e., valuation services, tax services, internal audit services, IT systems services, litigation support services, legal services, recruiting services, and corporate finance services).

<sup>116</sup> This section includes the Code's provisions that were adopted as part of the [Final Pronouncement: Revisions to the Non-Assurance Services Provisions of the Code](#), effective for audits of financial statements for periods beginning on or after December 15, 2022.

<sup>117</sup> Preparation of such statutory financial statements would not constitute the assumption of management responsibility because the firm would be required to use client-approved and client-prepared accounting records in preparing those statutory financial statements

<sup>118</sup> Revised paragraph R601.7 of the Code

<sup>119</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II B 1.

<sup>120</sup> SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II B 1.

impaired where the accountant prepared the statutory financial statements if those statements form the basis of the financial statements that are filed with us. Under these circumstances, an accountant or accounting firm who has prepared the statutory financial statements of an audit client is put in the position of auditing its own work when auditing the resultant U.S. GAAP financial statements.”

### Administrative Services

136. The Code permits the provision of administrative services that involve firms assisting audit clients with routine or mechanical tasks within the normal course of operations unless a self-review threat might be created.<sup>121</sup> The Code’s approach is based on the fact that providing administrative services to an audit client does not usually create a threat to independence when such services are clerical in nature and require little to no professional judgment.<sup>122</sup>
137. The SEC and PCAOB rules do not specifically address the provision of administrative services to an audit client. However, the SEC rules prohibit an accountant from acting as an employee of an audit client (see paragraph 42). The accountant would therefore need to be satisfied that the provision of the administrative services would not place the accountant in a position of acting as management or an employee of its audit client or result in the violation of any of the other guiding principles in the general standard.

### Valuation Services

138. Under the Code, valuation services are defined as services that involve making assumptions with regard to future developments, the application of appropriate methodologies and techniques and the combination of both to compute a certain value, or range of values, for an asset, a liability or for the whole or part of an entity.<sup>123</sup>
139. The Code<sup>124</sup> prohibits valuation services that might create self-review threat. However, if a valuation service does not create a self-review threat but might create an advocacy threat, a firm may provide the service to an audit client, provided that safeguards are applied to reduce the advocacy threat to an acceptable level and other applicable provisions in the Code are complied with.
140. The SEC prohibits the provision of the following valuation-related services to an audit client:
- Any appraisal service, valuation service, or any service involving a fairness opinion or contribution-in-kind report for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client’s financial statements.<sup>125</sup>
  - Any actuarially-oriented advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client other than assisting a client

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<sup>121</sup> Revised paragraph 602.2 A2 of the Code provides the following examples of such administrative services:

- Word processing or document formatting.
- Preparing administrative or statutory forms for client approval.
- Submitting such forms as instructed by the client.
- Monitoring statutory filing dates and advising an audit client of those dates.

<sup>122</sup> Revised paragraph 602.3 A1 of the Code

<sup>123</sup> Revised paragraph 603.2 A1 of the Code

<sup>124</sup> Revised paragraph 603.5 of the Code

<sup>125</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (iii)

in understanding the methods, models, assumptions, and inputs used in computing an amount unless it is reasonable to conclude that the results of such services will not be subject to audit procedures during an audit of the audit client's financial statements.<sup>126</sup>

141. Appraisal and valuation services include any process that involves valuing assets, both tangible and intangible, or liabilities – such as in-process research and development, financial instruments, assets and liabilities acquired in a merger, and real estate. Fairness opinions and contribution-in-kind reports are opinions and reports in which the accountant provides its opinion on the adequacy of consideration in a transaction.<sup>127</sup>
142. Valuation services to assist an audit client with tax reporting obligations or for tax planning purposes where the results of the valuation have no effect on the accounting records or the financial statements are considered in paragraphs 165 to 167 below.

#### Commentary

143. The objectives of the prohibitions in the Code and in the SEC rules appear to be the same, namely, to prohibit an accountant from undertaking a valuation service, the outcome of which will affect the accounting records or the financial statements on which the accountant will express an opinion and thereby result in the accountant auditing its own work.
144. In relation to valuation services that give rise to advocacy threat – despite the different conceptual approaches described in paragraph 33 of this Report – the Code's "self-review threat prohibition" significantly limits the types of valuation services giving rise to an advocacy threat that a firm may provide to PIE audit clients having applied appropriate safeguards to reduce such threats to an acceptable level. Although the Code might appear to be more permissive than the SEC rules, the outcome under the Code is not substantively different from that under the SEC rules.

## Tax Services

### General Tax Provisions

145. Tax gives rise to a broad range of services provided by a firm to an audit client that are often interrelated in practice and might be combined with other types of services, such as corporate finance services. Consequently, the Code does not define "tax services." Therefore, unless a tax service is explicitly prohibited by the Code, the firm is required to apply the conceptual framework to identify, evaluate and address threats that might be created by the provision of that tax service to an audit client.
146. Under the Code, in the case of audit clients that are PIEs, the provision of the following tax services are expressly prohibited:
- Calculations of current/deferred taxes for the purpose of preparing accounting entries that support such balances.
  - Tax advice that depends on a particular accounting treatment/financial statement presentation with respect to which there is reasonable doubt as to its appropriateness.
  - Acting as an advocate before a tribunal or court to resolve a tax matter.
  - Valuation for tax purposes if it might create a self-review threat.

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<sup>126</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01(c) (4) (iv)

<sup>127</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 3.

- Tax advisory and tax planning services if it might create a self-review threat.<sup>128</sup>
  - Assistance in the resolution of tax disputes if it might create a self-review threat.
147. The SEC rules are silent in relation to the provision of tax services to audit clients. However, an SEC release<sup>129</sup> explains that: “the Commission reiterates its long-standing position that an accounting firm can provide tax services to its audit clients without impairing the firm’s independence. Accordingly, accountants may continue to provide tax services such as tax compliance, tax planning, and tax advice to audit clients, subject to the normal audit committee pre-approval requirements under 2-01(c)(7).”
148. The SEC’s release also adds that: “...merely labeling a service as a “tax service” will not necessarily eliminate its potential to impair independence under Rule 2-01(b). Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant.”
149. The PCAOB rules addressing the provision of tax services to audit clients supplement the SEC’s general independence standards. PCAOB Rules 3522<sup>130</sup> and 3523<sup>131</sup> are designed to address potential ethics and independence considerations that might arise from a firm’s involvement in providing:
- Advice on tax positions that might be abusive (confidential transactions and aggressive tax position transactions), and
  - Tax compliance and planning services for those in a financial reporting oversight role.

#### *Aggressive Tax Positions and Confidential Transactions*

150. The revised NAS provisions prohibit firms from providing a tax service or recommending a transaction to an audit client if the service or transaction relates to marketing, planning, or opining in favor of a tax treatment that was initially recommended, directly or indirectly, by the firm or network firm, and a significant purpose of the tax treatment or transaction is tax avoidance unless the firm is confident that the proposed treatment has a basis in applicable tax law or regulation that is likely to prevail.<sup>132</sup>
151. While the SEC rules do not specifically address this topic, PCAOB Rule 3522<sup>133</sup> provides that “the registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period, provides any non-audit service to the audit client related to marketing, planning, or opining in favor of the tax treatment of, a transaction:
- Confidential Transactions<sup>134</sup> – a transaction offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid and advisor a fee; or

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<sup>128</sup> Paragraph 604.12 A2 of the Code identifies particular circumstances that would not create a self-review threat.

<sup>129</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission’s Requirements Regarding Auditor Independence, Section II B 11.

<sup>130</sup> PCAOB Rule 3522, Tax Transactions. These rules apply to audits of issuers and broker-dealers.

<sup>131</sup> PCAOB Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles. These rules apply to audits of issuers.

<sup>132</sup> Revised paragraph R604.4 of the Code

<sup>133</sup> PCAOB Rule 3522. Tax Transactions

<sup>134</sup> PCAOB Rule 3501 (c)(i)(1)

- Aggressive<sup>135</sup> Tax Position Transactions – that was initially recommended, directly or indirectly, by the registered public accounting firm and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws.”

#### Commentary

152. The Code and the PCAOB rules both include a general prohibition on the provision of certain tax services and transactions as described in paragraphs 150 and 151 above.<sup>136</sup> However, the Code’s requirement do not specifically address the provision of confidential transactions to an audit client. In such circumstances, the Code’s conceptual framework applies.

#### Specific Tax Provisions

##### *Tax Return Preparation*

153. Provided that the general provisions of the Code applicable to services provided to PIE audit clients are met, including the “self-review threat prohibition”, the Code does not prohibit the provision of tax return preparation services to an audit client. The Code recognizes that provision of such services does not usually create a threat because:
- Tax return preparation services are based on historical information and principally involve analysis and presentation of such historical information under existing tax law, including precedents and established practice; and
  - Tax returns are subject to such review or approval process the tax authority considers appropriate.<sup>137</sup>
154. The PCAOB’s position<sup>138</sup> is that “as a general matter, routine tax return preparation and tax compliance services have not raised independence concerns. In the case of most tax compliance services, the auditor does not prepare tax returns until after management has calculated and allocated its tax liability and the auditor has audited the income tax accounts to obtain reasonable assurance that they are fairly stated and are accompanied by appropriate disclosure. Also, in preparing a tax return, the auditor is not acting as an advocate for its client.”

##### *Tax Calculations*

155. The Code and the SEC rules do not contain specific provisions governing the preparation of tax calculations to audit clients.
156. The Code does, however, explicitly prohibit the provision of calculations of current and deferred tax liabilities (or assets) to an audit client for the purpose of preparing accounting entries that support such balances because such calculations create a self-review threat.<sup>139</sup>

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<sup>135</sup> While the Code does not mention the term “aggressive tax positions”, this topic might form part of IESBA’s ongoing Tax Planning and Related Services project. That project was launched in September 2021 to develop revisions to the Code addressing the ethical implications for professional accountants in business and professional accountants in public practice when they provide tax planning and related services to employing organizations and clients, respectively. The anticipated finalization date for the IESBA’s Tax Planning project is December 2023.

<sup>136</sup> The relevant requirement in the Code (i.e., paragraph R604.4) applies to all audit clients, including non-PIEs.

<sup>137</sup> Revised paragraph 604.6 A1 of the Code

<sup>138</sup> PCAOB Release No. 2004-015 (December 14, 2004)

<sup>139</sup> Revised paragraphs 604.8 A1 and R604.10 of the Code

## Commentary

157. While the SEC rules do not specifically prohibit an accountant from undertaking tax calculations for audit clients, the prohibition on the provision of accounting and bookkeeping services and the application of the SEC's principle that an accountant is prohibited from auditing its own work and acting as management would result in the same outcome as that under the Code.

## Tax Advisory and Tax Planning

158. The Code does not contain a general prohibition on the provision of tax advisory or tax planning services to an audit client unless the purpose of the tax advice is tax avoidance (see paragraphs 150 to 152 above).<sup>140</sup> However, the Code prohibits tax advisory and tax planning services:
- That would result in a firm assuming a management responsibility for an audit client.
  - Where the effectiveness of the tax advice depends on a particular accounting treatment or presentation in the financial statements, and the audit team has doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework.<sup>141</sup>
  - That might create a self-review threat.<sup>142</sup>
159. The Code sets out that providing tax advisory and tax planning services will not create a self-review threat if such services:
- a) Are supported by a tax authority or other precedent;
  - b) Are based on an established practice (being a practice that has been commonly used and has not been challenged by the relevant tax authority); or
  - c) Have a basis in tax law that the firm is confident is likely to prevail.<sup>143</sup>
160. If provision of the tax advisory services and tax planning services will not create a self-review threat, but might create an advocacy threat, a firm may provide the service if safeguards are available and are capable of being applied to reduce that advocacy threat to an acceptable level.<sup>144</sup>
161. As explained in paragraph 147 above, the SEC rules do not contain specific prohibitions in this area. However, an SEC release<sup>145</sup> states that "accountants may continue to provide tax services such as tax compliance, tax planning, and tax advice to audit clients, subject to the normal audit committee pre-approval requirements under 2-01(c)(7)." The release also adds that "...merely labeling a service as a "tax service" will not necessarily eliminate its potential to impair independence under Rule 2-01(b)". Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant."

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<sup>140</sup> This approach is based on the fact that tax advisory and tax planning services comprise a broad range of services, including advising the audit client how to structure its affairs in a tax-efficient manner or advising on the application of a tax law or regulation (Revised paragraph 604.11 A1 of the Code)

<sup>141</sup> Revised paragraph R604.13 of the Code

<sup>142</sup> Revised paragraph R604.15 of the Code

<sup>143</sup> Revised paragraph 604.12 A2 of the Code

<sup>144</sup> Revised paragraph 604.15 A1 of the Code provides examples of actions that might be safeguards to address an advocacy threat created by providing tax advisory and tax planning services to an audit client that is a PIE.

<sup>145</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 11.



162. The PCAOB<sup>146</sup> has stated that the provision of research and tax planning services to audit clients in connection with routine and even non-routine business transactions initiated by the audit client generally would not raise auditor independence concerns, provided that
- The audit client makes the decisions relating to, and takes responsibility for, both the tax work and the presentation of tax related accounts and other matters in the financial statements, and
  - The firm does not provide non-audit services relating to aggressive tax strategies that are prohibited (see paragraphs 150-151 above).

#### Commentary

163. Although the SEC rules do not set out specific prohibitions regarding provisions of tax-planning and tax advisory services, firms also have to consider the PCAOB<sup>147</sup> standard on tax transactions, and they have to meet the requirements for obtaining the audit committee's pre-approval to the provision of the tax service.
164. In view of the Code's prohibitions applicable to the provision of tax advisory and tax planning services (see paragraph 158 above) and the requirement to apply the conceptual framework that govern the firm's assessment regarding the permissibility of providing tax planning and tax services.

#### *Tax Services Involving Valuations*

165. The provision of tax services which involve valuations can arise in a range of circumstances, including (i) merger and acquisition transactions, (ii) group restructurings and corporate reorganizations, (iii) transfer pricing studies, and (iv) stock-based compensation arrangements.<sup>148</sup> Such services might create a self-review threat and an advocacy threat.<sup>149</sup>
166. The Code prohibits the provision of tax services involving valuations to an audit client if they might create a self-review threat.<sup>150, 151</sup> No such prohibition exists if such services create only an advocacy threat; the Code permits a firm to apply safeguards, if available, to reduce the advocacy threat to an acceptable level.<sup>152</sup>
167. The SEC's release<sup>153</sup> states that the "rules do not prohibit an accounting firm from providing such services [appraisal or valuation services, fairness opinions, or contribution-in-kind reports] for non-financial reporting (e.g., transfer pricing studies, cost segregation studies, and other tax-only valuations) purpose."

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<sup>146</sup> PCAOB Release No. 2004-015 (December 14, 2004)

<sup>147</sup> PCAOB Standard 3522

<sup>148</sup> Revised paragraph 604.16 A1 of the Code

<sup>149</sup> Revised paragraph 604.17 A1 of the Code

<sup>150</sup> Revised paragraph R604.19 of the Code

<sup>151</sup> Performing a valuation for tax purposes for an audit client will not create a self-review threat if:

- (a) The underlying assumptions are either established by law or regulation, or are widely accepted; or
- (b) The techniques and methodologies to be used are based on generally accepted standards or prescribed by law or regulation, and the valuation is subject to external review by a tax authority or similar regulatory authority. (Paragraph 604.17 A3 of the Code)

<sup>152</sup> Revised paragraph 604.19 A1 of the Code

<sup>153</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 3.

## Commentary

168. The provision of tax services involving valuations to an audit client when such service might create a self-review threat is explicitly prohibited under the Code. The SEC rules relating to valuations (see paragraphs 138-144 above) provide an exception when such valuation is for non-financial reporting purposes. The provision of valuations for non-financial reporting purposes is not addressed in the Code. As the provision of such valuations in such circumstances is likely to comply with the general criteria (see paragraph 108) governing the provision of NAS to audit clients, the outcome under the Code is not substantively different from that under the SEC rules.

## *Assistance in the Resolution of Tax Disputes*

169. A firm might be asked to assist an audit client in the resolution of a tax dispute, for example, where a tax authority has notified an audit client that arguments on a particular issue have been rejected and the tax authority or the client refers the matter for determination in a formal proceeding before a tribunal or court.<sup>154</sup>
170. Under the Code, a firm is prohibited from assisting an audit client in the resolution of tax disputes if the provision of that assistance might create a self-review threat.<sup>155</sup> No such prohibition exists if such services create only an advocacy threat; in such circumstances, the Code permits a firm to apply safeguards, if available, to reduce the advocacy threat to an acceptable level.<sup>156</sup>
171. The Code specifically prohibits a firm from acting for a PIE audit client as an advocate before a tribunal or court.<sup>157</sup> However, a firm may act in an advisory role in relation to the matter that is being heard before a tribunal or court by, for example, responding to specific requests for information, providing factual accounts or testimony about the work performed, or assisting the client in analyzing the tax issues related to the matter.<sup>158</sup>
172. The SEC rules do not include specific prohibitions regarding the provision of assistance in tax disputes. However, the SEC's release<sup>159</sup> sets out that "merely labeling a service as a "tax service" will not necessarily eliminate its potential to impair independence under Rule 2-01(b). Audit committees and accountants should understand that providing certain tax services to an audit client would, as described below, or could, in certain circumstances, impair the independence of the accountant. Specifically, accountants would impair their independence by representing an audit client before a tax court, district court, or federal court of claims."

## Commentary

173. Both the Code and the SEC rules prohibit firms from representing an audit client in tax matters before a tribunal or court.

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<sup>154</sup> Revised paragraph 604.20 A1 of the Code

<sup>155</sup> Revised paragraph R604.24 of the Code

<sup>156</sup> Revised paragraph 604.24 A1 of the Code

<sup>157</sup> Revised paragraph R604.26 of the Code

<sup>158</sup> Revised paragraph 604.27 A1 of the Code

<sup>159</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 11

**Tax Services for Persons in Financial Reporting Oversight Roles**

174. PCAOB Rule 3523<sup>160</sup> prohibits an accounting firm, with limited exceptions<sup>161</sup>, from providing a tax service to a person in a financial reporting oversight role at an issuer audit client, or an immediate family member of such person. The PCAOB Rule addresses concern that performing tax services for certain individuals involved in the financial reporting processes of an audit client creates an appearance of a mutual interest between the auditor and those individuals.<sup>162</sup>

**Commentary**

175. The Code does not include an equivalent provision. However, based on the application of the conceptual framework, IESBA Staff is of the view that a firm would be expected to consider whether the provision of tax services to a person in a financial reporting oversight role at an audit client might give rise to a familiarity threat or compromise the firm's judgment.

**Internal Audit Services**

176. The provision of internal audit services to an audit client might:

- Result in a firm (or network firm) assuming a management responsibility (see paragraphs 35-40). The Code provides examples of internal audit activities that are prohibited because they would result in a firm assuming management responsibility.<sup>163</sup>
- Create a self-review threat in relation to the audit of the financial statements on which the firm will express an opinion.<sup>164</sup> The Code prohibits firms from providing internal audit services to a PIE audit client if the provision of such services might create a self-review threat.<sup>165</sup>

177. As internal audit services might involve matters that are operational in nature, they do not necessarily relate to matters that will be subject to consideration in relation to the audit of the financial statements and therefore might not create a self-review threat.<sup>166</sup>

178. The Code includes examples of services that are prohibited because they create a self-review threat, namely services that relate to (i) the internal controls over financial reporting, (ii) financial

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<sup>160</sup> PCAOB Rule 3523. Tax Services for Persons in Financial Reporting Oversight Roles

<sup>161</sup> The PCAOB rule is not applicable to a person in a financial reporting role if:

- (a) the person is in a financial reporting oversight role at the issuer audit client only because he or she serves as a member of the board of directors or similar management or governing body of the audit client;
- (b) the person is in a financial reporting oversight role at the issuer audit client only because of the person's relationship to an affiliate of the entity being audited:
  - (1) Whose financial statements are not material to the consolidated financial statements of the entity being audited; or
  - (2) Whose financial statements are audited by an auditor other than the firm or an associated person of the firm; or
- (c) the person was not in a financial reporting oversight role at the issuer audit client before a hiring, promotion, or other change in employment event and the tax services are:
  - (1) Provided pursuant to an engagement in process before the hiring, promotion, or other change in employment event; and
  - (2) Completed on or before 180 days after the hiring or promotion event.

<sup>162</sup> PCAOB Release No. 2005-014 July 26, 2005

<sup>163</sup> Revised 605.3 A2 of the Code

<sup>164</sup> Revised 605.4 A1 of the Code

<sup>165</sup> Revised R605.6 of the Code

<sup>166</sup> Revised 605.2 A2 of the Code

accounting systems that generate information for the client's accounting records or financial statements on which the firm will express an opinion, or (iii) amounts or disclosures that relate to the financial statements on which the firm will express an opinion.<sup>167</sup>

179. The SEC rules prohibit providing any internal audit services outsourced by an audit client that relates to the audit client's internal accounting controls, financial systems, or financial statements, for an audit client, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements.<sup>168</sup>
180. Similar to the Code's approach the SEC release<sup>169</sup> also states that "the prohibition does not preclude the accountant from performing operational internal audits unrelated to the internal accounting controls, financial systems, or financial statements".
181. Both the Code<sup>170</sup> and the SEC's releases<sup>171</sup> recognize that firms should be able to provide advice and recommendations in relation to information or matters that they identify in the course of an audit relating to the audit client's internal controls (see also paragraphs 119 to 121).

#### *Commentary*

182. Overall, the frameworks of the Code and the SEC prohibit the provision of the same types of internal audit services to an audit client.

#### **Information Technology (IT) System Services**

183. The provision of IT system services to an audit client might (i) result in a firm assuming management responsibility or (ii) create a self-review threat if there is a risk that the results of the services will affect the audit of the financial statements on which the firm will express an opinion.<sup>172</sup>
184. The Code prohibits the provision of IT systems services to a PIE audit client if those services might create a self-review threat.<sup>173</sup> Examples of services that might create a self-review threat include those involving designing or implementing IT systems that:
- (a) Form part of the internal control over financial reporting; or

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<sup>167</sup> Revised 605.6 A1 of the Code

<sup>168</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (v)

<sup>169</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 5

<sup>170</sup> Revised R600.17 of the Code

<sup>171</sup> SEC No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 5) states that "...during the conduct of the audit in accordance with generally accepted auditing standards ("GAAS") or when providing attest services related to internal controls, the auditor evaluates the company's internal controls and, as a result, may make recommendations for improvements to the controls. Doing so is a part of the accountant's responsibilities under GAAS or applicable attestation standards and, therefore, does not constitute an internal audit outsourcing engagement." Furthermore, the SEC's release added that "along those lines, this prohibition on "outsourcing" does not preclude engaging the accountant to perform nonrecurring evaluations of discrete items or other programs that are not in substance the outsourcing of the internal audit function. For example, the company may engage the accountant, subject to the audit committee pre-approval requirements, to conduct "agreed-upon procedures" engagements related to the company's internal controls, since management takes responsibility for the scope and assertions in those engagements. The prohibition also does not preclude the accountant from performing operational internal audits unrelated to the internal accounting controls, financial systems, or financial statements.

<sup>172</sup> Revised 606.4 A1 of the Code

<sup>173</sup> Revised R606.6 of the Code

- (b) Generate information for the client's accounting records or financial statements on which the firm will express an opinion.<sup>174</sup>
185. The SEC rules prohibit an accountant from providing "any service [*related to the financial information systems design and implementation*] unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
- (a) Directly or indirectly operating, or supervising the operation of, the audit client's information system or managing the audit client's local area network; or
  - (b) Designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the audit client's financial statements or other financial information systems taken as a whole."<sup>175</sup>
186. In its 2003 Adopting Release, the SEC stated that "designing, implementing, or operating systems affecting the financial statements may place the accountant in a management role, or result in the accountant auditing his or her own work or attesting to the effectiveness of internal control systems designed or implemented by that accountant."<sup>176</sup>
187. Like the Code, the SEC's release also stated that "such rules do not preclude an accounting firm from working on hardware or software systems that are unrelated to the audit client's financial statements or accounting records as long as those services are pre-approved by the audit committee".<sup>177</sup>
188. The SEC's release further stated that "this prohibition does not preclude the accountant from evaluating the internal controls of a system as it is being designed, implemented or operated either as part of an audit or attest service and making recommendations to management. Likewise, the accountant would not be precluded from making recommendations on internal control matters to management or other service providers in conjunction with the design and installation of a system by another service provider".<sup>178</sup>

#### *Commentary*

189. The Code and the SEC both address similar concerns and achieve equivalent outcomes regarding IT system services.
190. However, the practice based on the SEC release regarding provision of advice and recommendation in conjunction with the design and installation of an IT systems may differ from the Code's provisions. This is because the Code only allows the provision of advice and recommendations to a PIE audit client that might give rise to a self-review threat if the recommendations are in relation to information or matters arising in the course of an audit provided.

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<sup>174</sup> Revised 606.6 A1 of the Code

<sup>175</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (ii)

<sup>176</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 2

<sup>177</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 2

<sup>178</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 2

## Litigation Support Services

191. Litigation support services include, for example, (i) assisting with document management and retrieval; (ii) acting as a witness, including an expert witness; (iii) calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute; or (iv) forensic or investigative services.<sup>179</sup>
192. Providing litigation support services to an audit client might create a self-review threat or an advocacy threat. The Code prohibits the provision of litigation support services to a PIE audit client if it might create a self-review threat.<sup>180</sup> The provision of advice in connection with a legal proceeding, the outcome of which might affect the quantification of a provision or other amount in the financial statements on which the firm will express an opinion is an example of a service that creates a self-review threat.<sup>181</sup>
193. Litigation support services might also create advocacy threats. The Code does not explicitly prohibit the provision of litigation services that might create an advocacy threat – other than acting as an expert witness if not appointed to act in circumstances described in paragraph 195 below - provided that the firm applies the conceptual framework and ensures that the level of such threat is at an acceptable level.<sup>182</sup>
194. The Code addresses the position where a firm, or an individual within a firm, acts as a witness for an audit client. The Code distinguishes between giving evidence to a tribunal or court as a witness of fact or as an expert witness.<sup>183</sup>
195. Under the Code,<sup>184</sup> a firm is permitted to act for an audit client as an expert witness, if it is:
- (a) Appointed by a tribunal or court to act as an expert witness in a matter involving a client; or
  - (b) Engaged to advise or act as an expert witness in relation to a class action (or an equivalent group representative action) provided that:
    - (i) The firm's audit clients constitute less than 20% of the members of the class or group (in number and in value);
    - (ii) No audit client is designated to lead the class or group; and
    - (iii) No audit client is authorized by the class or group to determine the nature and scope of the services to be provided by the firm or the terms on which such services are to be provided.
196. The SEC rules prohibit the provision of an expert opinion or other expert service for an audit client, for the purpose of advocating an audit client's interests in litigation or in a regulatory or administrative proceeding or investigation. An accountant is also prohibited from providing such services to an audit client's legal representative.<sup>185</sup> An SEC's release explains<sup>186</sup> that although all

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<sup>179</sup> Revised 607.2 A1 of the Code

<sup>180</sup> Revised R607.6 of the Code

<sup>181</sup> Revised 607.6 A1 of the Code

<sup>182</sup> Revised 607.6 A2 of the Code

<sup>183</sup> Revised 607.7 A1 of the Code

<sup>184</sup> Revised 607.7 A3 and R607.9 of the Code

<sup>185</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (x)

<sup>186</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Footnote 97;

services provided by an accountant might be perceived to be expert services, this prohibition only applies to services that involve advocacy in proceedings and investigations and does not apply to other permitted non-audit services, such as tax services.

197. Like the Code, the SEC rules make it clear that an accountant's independence is not impaired if an accountant provides factual accounts, including in testimony, of work performed or explains the positions taken or conclusions reached during the performance of any permitted service provided by the accountant for the audit client.<sup>187</sup> However, the SEC rules do not provide an exception if the witness is appointed by the court or engaged in relation to a class action, as in the case of the Code.
198. An SEC's release also stated that the SEC rules "do not preclude an audit committee or, at its direction, its legal counsel, from engaging the accountant to perform internal investigations or fact-finding engagements. These types of engagements might include, among others, forensic or other fact-finding work that results in the issuance of a report to the audit client."<sup>188</sup>

#### *Commentary*

199. The SEC's restrictions in relation to litigation support services extend beyond the Code's prohibitions as they:
- Prohibit the provision of any kind of expert services for the purpose of advocating an audit client's interest.<sup>189</sup>
  - Do not permit the provision of litigation services to affiliates of an audit client. In contrast, the Code allows the provision of otherwise prohibited litigation support services, including expert witness services, to related entities provided certain conditions are met (see paragraph 130 above).

#### **Legal Services**

200. Legal services are defined in the Code as those services for which the individual providing the services must either:
- Have the required legal training to practice law; or
  - Be admitted to practice law before the courts of the jurisdiction in which such services are to be provided.<sup>190</sup>
201. The Code does not contain a general prohibition on the provision of such legal services above to an audit client. In the case of PIE audit clients, the Code prohibits:
- Provision of legal advice if it might create a self-review threat.<sup>191</sup>

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<sup>187</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (x)

<sup>188</sup> SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II. B 10

<sup>189</sup> In situations involving advocacy, the provision of expert services by the accountant makes the accountant part of the "team" that has been assembled to advance or defend the client's interests. The appearance of advocacy created by providing such expert services is sufficient to deem the accountant's independence impaired. The prohibition on providing "expert" services included in this rule covers engagements that are intended to result in the accounting firm's specialized knowledge, experience and expertise being used to support the audit client's positions in various adversarial proceedings. See SEC Release No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II. B 10.

<sup>190</sup> Revised 608.2 A1 of the Code

<sup>191</sup> Revised R608.7 of the Code

- A partner or employee of the firm or the network firm serving as General Counsel of an audit client<sup>192</sup>
- Acting in an advocacy role for an audit client in resolving a dispute or litigation before a tribunal or court<sup>193</sup>

202. The SEC rules prohibit the provision of any legal service to an audit client that, under circumstances in which the service is provided, could be provided only by someone licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided.<sup>194,195</sup>

#### *Commentary*

203. The Code focuses only on specific types of legal services and does not establish a general prohibition on the provision of legal services by firms to their audit clients. The Code also permits the provision of prohibited legal services to related entities of an audit client provided that certain conditions are met (see paragraph 130 above).

204. By contrast, the SEC rules prohibit the provision of legal services to an audit client or to any affiliate of that audit client.

#### **Recruiting Services**

205. The provision of recruiting services to an audit client (i) might result in a firm assuming management responsibility and (ii) might create a self-interest, familiarity or intimidation threat.<sup>196</sup>

206. The Code prohibits firms from providing the following recruiting services to an audit client:

- Acting as a negotiator on the client's behalf, and<sup>197</sup>
- Services that relate to:<sup>198</sup>
  - (a) Searching for or seeking out candidates;
  - (b) Undertaking reference checks of prospective candidates;
  - (c) Recommending the person to be appointed; or
  - (d) Advising on the terms of employment, remuneration or related benefits of a particular candidate,

with respect to the following positions:

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<sup>192</sup> Revised R608.9 of the Code

<sup>193</sup> Revised R608.11 of the Code

<sup>194</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (ix)

<sup>195</sup> The SEC's Adopting Release stated that: "We believe that a lawyer's core professional obligation is to advance clients' interests. Rules of professional conduct in the U.S. require the lawyer to "represent a client zealously and diligently within the bounds of the law." The lawyer must "take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor... In the exercise of professional judgment, a lawyer should always act in a manner consistent with the best interests of the client." We have long maintained that an individual cannot be both a zealous legal advocate for management or the client company, and maintain the objectivity and impartiality that are necessary for an audit." See SEC Release No. 33-8183 (January 28, 2003), *Strengthening the Commission's Requirements Regarding Auditor Independence*, Section II. B 9.

<sup>196</sup> Revised R609.3 and 609.4 A1 of the Code

<sup>197</sup> Revised R609.5 of the Code

<sup>198</sup> Revised R609.6 of the Code



- (i) A director or officer of the entity; or
- (ii) A member of senior management in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

207. However, the Code acknowledges that provision of the following services to an audit client does not usually create a threat to a firm's independence:

- Reviewing the professional qualifications of a number of applicants and providing advice on their suitability for the position.
- Interviewing candidates and advising on a candidate's competence for financial accounting, administrative or control positions.

208. The SEC rules prohibit the following human resources services:<sup>199</sup>

- Searching for or seeking out prospective candidates for managerial, executive, or director positions;
- Engaging in psychological testing, or other formal testing or evaluation programs;
- Undertaking reference checks of prospective candidates for an executive or director position;
- Acting as a negotiator on the audit client's behalf, such as determining position, status or title, compensation, fringe benefits, or other conditions of employment; or
- Recommending, or advising the audit client to hire, a specific candidate for a specific job (except that an accounting firm may, upon request by the audit client, interview candidates and advise the audit client on the candidate's competence for financial accounting, administrative, or control positions).<sup>200</sup>

209. The SEC's release explains that "assisting management in human resource selection or development places the accountant in the position of having an interest in the success of the employees that the accountant has selected, tested, or evaluated. Accordingly, observers may perceive that an accountant would be reluctant to suggest the possibility that those employees failed to perform their jobs appropriately, or at least reasonable investors might perceive the accountant to be reluctant, because doing so would require the accountant to acknowledge shortcomings in its human resource service. The accountant also might have other incentives not to report such employees' ineffectiveness, including that the accountant would identify and be identified with the recruited employees."<sup>201</sup>

### *Commentary*

210. The prohibitions regarding recruiting/ human resources services in the SEC rules and in the Code mainly cover the same types of services, with a few differences; for example:

- The SEC rules prohibit accountants from engaging in psychological testing, or other formal testing or evaluation programs for the audit client. In contrast, these services are not explicitly prohibited under the Code's provisions.

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<sup>199</sup> The Code's provisions use the term "recruiting services", while the SEC/PCAOB rules use the term "human resources services." The IESBA Staff is of the view that the meaning of these two terms is substantially the same.

<sup>200</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (viii)

<sup>201</sup> No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 7

- While the SEC rules prohibit an accountant from recommending or advising an audit client to hire a specific candidate for a position<sup>202</sup>, the equivalent Code prohibition applies only if such services relate to the engagement of directors, officers, or specific members of senior management.

## Corporate Finance Services

211. The Code provides that the provision of corporate finance services<sup>203</sup> by a firm to an audit client might result in the firm assuming management responsibility, and might create a self-review threat.<sup>204</sup> (Please also see paragraph 213)

212. As a result, the Code prohibits firms from providing to an audit client:

- Corporate finance services that involve promoting, dealing in, or underwriting the shares, debt or other financial instruments issued by the audit client or providing advice on investment in such shares, debt or other financial instruments;<sup>205</sup>
- Advice in relation to corporate finance services where:
  - (a) The effectiveness of such advice depends on a particular accounting treatment or presentation in the financial statements on which the firm will express an opinion; and
  - (b) The audit team has doubt as to the appropriateness of the related accounting treatment or presentation under the relevant financial reporting framework;<sup>206</sup>
- Corporate finance services, if the provision of such services might create a self-review threat.<sup>207</sup>

213. Apart from the risk of assuming management responsibility and the self-review threat, the Code also states that the provision of corporate finance services might create an advocacy threat. If the corporate finance service is not specifically prohibited, the Code does not include general prohibition from services that only create an advocacy threat, provided that the firm applies the conceptual framework and ensures that the level of such threat is at an acceptable level.<sup>208</sup>

214. The SEC rules address explicitly: (i) broker-dealer, (ii) investment adviser, and (iii) investment banking services, and prohibit accountants from:

- Acting as a broker-dealer (registered or unregistered), promoter, or underwriter, on behalf of an audit client,
- Making investment decisions on behalf of the audit client or otherwise having discretionary authority over an audit client's investments,
- Executing a transaction to buy or sell an audit client's investment, or
- Having custody of assets of the audit client, such as taking temporary possession of

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<sup>202</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4)(vii)(E)

<sup>203</sup> Revised 610.2 A1 of the Code

<sup>204</sup> Revised 610.3 A1 of the Code

<sup>205</sup> Revised R610.5 of the Code

<sup>206</sup> Revised R610.6 of the Code

<sup>207</sup> Revised R610.6 of the Code

<sup>208</sup> Revised 610.3 A1 and 610.8 A1 of the Code

securities purchased by the audit client.<sup>209,210</sup>

215. The SEC's approach is based on a view that "selling – directly or indirectly – an audit client's securities is incompatible with the accountant's responsibility of assuring the public that the company's financial condition is fairly presented. When an accountant, in any capacity, recommends to anyone (including non-audit clients) that they buy or sell the securities of an audit client or an affiliate of the audit client, the accountant has an interest in whether those recommendations were correct. That interest could affect the audit of the client whose securities, or whose affiliate's securities, were recommended."<sup>211</sup>
216. Furthermore, "broker-dealers often give advice and recommendations on investments and investment strategies. The value of that advice is measured principally by the performance of a customer's securities portfolio. When the customer is an audit client, the accountant has an interest in the value of the audit client's securities portfolio, even as the accountant must determine whether management has properly valued the portfolio as part of an audit. Thus, the accountant would be placed in a position of auditing his or her own work. Furthermore, the accountant is placed in a position of acting as an advocate on behalf of the client."<sup>212</sup>

### *Commentary*

217. Both frameworks prohibit corporate finance services that:
- Involve promoting, dealing in, or underwriting the shares, debt or other financial instruments issued by the audit client – including acting as a broker-dealer – or providing advice on investment, and
  - Services that might create a self-review threat or would put the firm in a position of auditing its own work.
218. In relation to corporate finance services that give rise to an advocacy threat the Code does not include a general prohibition, while the overarching principles in the SEC rules restrict accountants from providing any corporate finance services that place the accountant in a position of being an advocate for the audit client or violating any of the other four principles. Despite the conceptually different approaches between the two frameworks as described in paragraph 33, in the IESBA's view,<sup>213</sup> the combination of the self-review threat prohibition and the prohibitions on the provision of certain corporate finance services that might create an advocacy threat will reduce the types of corporate finance services giving rise to an advocacy threat that a firm may provide to PIE audit clients (subject to compliance with the conceptual framework).
219. In relation to other types of corporate finance services, the Code relies on the application of overarching requirements. The SEC rules specify that other services for example, having custody of assets of the audit client is prohibited. While the Code does not include such a prohibition,

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<sup>209</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (4) (viii)

<sup>210</sup> PCAOB Interim Independence Standard, ET Section 101.05 sets out specific group of services such as investment advisory or management services and corporate finance consulting or advisory services that would impair the firm's independence. The specific list of services is in line with the SEC's relevant prohibitions, however PCAOB interim standard also includes the situation when the firm commits the client to the terms of a transaction or consummate a transaction on behalf of the client.

<sup>211</sup> No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 8

<sup>212</sup> No. 33-8183 (January 28, 2003), Strengthening the Commission's Requirements Regarding Auditor Independence, Section II B 8

<sup>213</sup> Basis for Conclusions, [Revisions to Non-Assurance Service Provisions in the Code](#)

firms have to apply the conceptual framework to determine whether such service is permissible or not under the particular circumstances.

## **D. Communication with Those Charged with Governance (TCWG)**

### **Communication of Independence Matters**

220. Transparency and auditor communication of independence related matters to TCWG or to the audit committee play an important role in the oversight of the financial reporting process and auditor independence under both frameworks. Although, the definition of TCWG in the Code<sup>214</sup> is broader than the audit committee definition in the SEC<sup>215</sup> and PCAOB<sup>216</sup> rules, for the purposes of this Report the definitions of TCWG and audit committees cover individuals performing the same function.<sup>217</sup>

#### *Firm Communications Requirements Under the Code*

221. The provisions of the Code in relation to communication with TCWG build on the requirements of the IAASB's International Standard on Auditing 260 (Revised), *Communication with Those Charged with Governance*. ISA 260 (Revised) requires<sup>218</sup> an auditor of a listed entity to confirm to TCWG that the engagement team and others in the firm, as appropriate, the firm and, when applicable, network firms, have complied with relevant ethical requirements regarding independence. In addition, an auditor is required to disclose:

- All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, might reasonably be thought to bear on independence. This includes the total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity;<sup>219</sup> and
- The safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

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<sup>214</sup> Based on the Code's Glossary TCWG are the person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance might include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

<sup>215</sup> Based on SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (f) (17), in the context of this section audit committee is defined in Section 3(a)(58) of the Securities Exchange Act of 1934 (15 U.S.C.8c(a)(58)):

(A) a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer; and

(B) if no such committee exists with respect to an issuer, the entire board of directors of the issuer.

<sup>216</sup> PCAOB Rule 3501 the term "audit committee" means a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity; if no such committee exists with respect to the entity, the entire board of directors of the entity. For audits of non-issuers, if no such committee or board of directors (or equivalent body) exists with respect to the entity, "audit committee" means the person(s) who oversee(s) the accounting and financial reporting processes of the entity and audits of the financial statements of the entity.

<sup>217</sup> Based on the Code's definition, TCWG also include organizations or persons overseeing the strategic direction of the entity and obligations related to the accountability of the entity.

<sup>218</sup> Paragraph 17 (a) of ISA 260 (Revised)

<sup>219</sup> These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor

222. When disclosure is not specifically required by professional standards or laws or regulations, the Code encourages regular communication between a firm and TCWG of all audit clients – including PIEs and non-PIEs - regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication is intended to enable TCWG to:
- (a) Consider the firm's judgments in identifying and evaluating threats;
  - (b) Consider how threats have been addressed, including the appropriateness of safeguards when they are available and capable of being applied; and
  - (c) Take appropriate action.
223. The revised NAS and fee-related provisions revisions to the Code have introduced more detailed and specific requirements<sup>220</sup> regarding auditor communication with TCWG about NAS and fee-related matters. The main purpose of the enhanced provisions is to provide a basis for a meaningful, two-way discussion with TCWG about NAS and fee-related matters, which will assist TCWG in assessing the firm's independence.

#### *Firm Communications Requirements Under the PCAOB Standards*

224. The PCAOB rules<sup>221</sup> requires a firm to affirm to the audit committee annually in writing that, as of the date of the communication, it is independent in compliance with PCAOB rule 3520<sup>222</sup>. In addition, prior to accepting an initial engagement and at least annually, a firm is required to
- Describe in writing, to the audit committee, all relationships between the firm or any affiliates of the firm and the audit client or persons in financial reporting oversight roles, as of the date of the communication, which might reasonably be thought to bear on independence;
  - Discuss with the audit committee the potential effects of the relationships described above on the firm's independence; and
  - Document the substance of its discussions with the audit committee.

#### *Commentary*

225. Both frameworks require audit firms to inform TCWG or the audit committee about any relationships and other matters that might reasonably bear on independence and so enable TCWG and the audit committee to assess the firm's independence. The PCAOB rules also specify the timing, form and manner in which the communication is to be documented.
226. The Code contains detailed guidance regarding communication of fee-related information to enable TCWG to consider whether any independence considerations arise from the scale or nature of such fees. The SEC and PCAOB rules<sup>223</sup> do not address in general the communication

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<sup>220</sup> See revised paragraphs 410.22 A1 to R410.28 for communication requirements relating to fees and paragraphs 600.19 A1 to R600.24 for communication requirements about NAS.

<sup>221</sup> PCAOB Rule 3526. Communication with Audit Committees Concerning Independence

<sup>222</sup> PCAOB Rule 3520 requires the firm and its associated persons to be independent of the firm's audit client throughout the audit and professional engagement period.

<sup>223</sup> In connection with seeking audit committee pre- approval of certain tax services PCAOB Rule 3524 requires the communication to the audit committee of the fee structure for the engagement, and any compensation arrangement or other agreement (such as a referral agreement, a referral fee or fee-sharing arrangement,) between the firm and any person (other than the audit client) with respect to the promoting, marketing, or recommending of a transaction covered by the service.

of fee-related matters to audit committees. However, as SEC rules requires disclosure of fees<sup>224</sup> (see paragraph 102) and the pre-approval<sup>225</sup> of audit and permitted NAS and as part of that process, fees might be considered by the audit committee.

## **Pre-Approval of NAS/Non-Audit Services for Audit Clients**

### *Code's Provisions*

227. The 2021 NAS-related revisions introduced enhanced communication and approval requirements to be complied with by firms prior to the provision of NAS to an audit client. Unless otherwise addressed by a pre-determined process agreed between the firm and TCWG<sup>226</sup>, the firm is required to:
- (a) Inform TCWG of the PIE that the firm has determined that the provision of the NAS is not prohibited and will not create a threat to the firm's independence, or that any identified threat is at an acceptable level or, if not, will be eliminated or reduced to an acceptable level.
  - (b) Provide TCWG of the PIE with information to enable them to make an informed assessment about the impact of the provision of the NAS on the firm's independence.
  - (c) Obtain concurrence from TCWG of the PIE before providing a NAS to an audit client.<sup>227</sup>
228. This requirement above covers NAS that are to be provided to (i) the PIE; (ii) any entity that controls that PIE, directly or indirectly; or (iii) any entity that is controlled directly or indirectly by that PIE.
229. The Code also addresses the situation where a firm is prohibited from providing information about a proposed NAS to TCWG of the PIE, or where the provision of such information would result in disclosure of sensitive or confidential information.<sup>228,229</sup>
230. Under the Code, having considered any matters raised by TCWG of the audit client or by the proposed recipient of the proposed service, a firm is required to decline the NAS or end the audit engagement if:

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<sup>224</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 240.14a-101 Schedule 14A. Information required in proxy statement – Item 9

<sup>225</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (7)

<sup>226</sup> In the [Basis for Conclusions](#), *Revisions to Non-Assurance Service Provisions in the Code* the IESBA considered whether there should be any constraints on the matters that may be addressed in any process agreed by a firm and TCWG of a PIE. It concluded that it was for TCWG to determine what was acceptable to enable them to discharge their governance responsibilities. Examples of arrangements that could be addressed in any such process include:

- To pre-approve specific categories of NAS for specified related entities where TCWG are satisfied that any threats to independence would be at an acceptable level;
- To allocate responsibilities and any required reporting between TCWG of multiple PIEs within the same group; and
- To provide monetary limits for delegated authority for specific approvals within preapproved categories.

<sup>227</sup> Revised paragraphs R600.21 and R600.22 of the Code

<sup>228</sup> In such instances, the firm may provide the proposed NAS if:

- (a) The firm provides such information as it is able without breaching its legal or professional obligations;
- (b) The firm informs TCWG of the PIE that the provision of the NAS will not create a threat to the firm's independence, or that any identified threat is at an acceptable level; and
- (c) TCWG do not disagree with the firm's conclusion about the impact of the proposed NAS on the firm's independence .

<sup>229</sup> Revised paragraph R600.23 of the Code

*\*\*As of March 3, 2022 \*\**

- (a) The firm or the network firm is not permitted to provide any information to TCWG of the PIE; or
- (b) TCWG of the PIE disagree with the firm's conclusion that the provision of the service will not create a threat to the firm's independence from the client or that any identified threat is at an acceptable level or, if not, will be eliminated or reduced to an acceptable level.<sup>230</sup>

#### *SEC and PCAOB rules*

231. Before an accountant is engaged by an issuer or its subsidiaries, or by a registered investment company, to provide an audit or non-audit service, the SEC rules require that the engagement is:
- (a) Approved by the issuer's or registered investment company's audit committee; or
  - (b) Entered into pursuant to pre-approval policies and procedures established by the audit committee of the issuer<sup>231</sup> or registered investment company, provided the (i) policies and procedures are detailed as to the particular service, (ii) the audit committee is informed of each service, and (iii) such policies and procedures do not include delegation of the audit committee's responsibilities to management.<sup>232</sup>
232. With respect to the provision of services other than audit, review or attest services, the SEC rules provide de-minimis exceptions from the pre-approval requirement if:
- (a) The aggregate amount of all such services provided constitutes no more than five percent of the total amount of revenues paid by the audit client to the accountant during the fiscal year in which the services are provided;
  - (b) Such services were not recognized by the issuer at the time of the engagement to be non-audit services; and
  - (c) Such services are promptly brought to the attention of the audit committee of the issuer or registered investment company and approved prior to the completion of the audit by the audit committee or by one or more members of the audit committee who are members of the board of directors to whom authority to grant such approvals has been delegated by the audit committee.<sup>233</sup>
233. The SEC rules also require an accountant to obtain pre-approval from the registered investment company's audit committee where the accountant proposes to provide non-audit services to the investment company's investment adviser (not including a sub-adviser whose role is primarily portfolio management and is sub-contracted or overseen by another investment adviser) and any

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<sup>230</sup> Revised paragraph R600.24 of the Code

<sup>231</sup> The SEC rules requires the issuer to disclose the audit committee's pre-approval policies and procedures in the company's proxy statement. Additionally, to the extent that the audit committee has applied the de minimis exception, the issuer must disclose the percentage of the total fees paid to the independent accountant where the de minimis exception was used. This information should be provided by category.( SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 240.14a-101 Schedule 14A. Information required in proxy statement – Item 9)

<sup>232</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (7) (i) (A)-(B)

<sup>233</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (7) (i) (C)

entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registered investment company.<sup>234, 235</sup>

234. The PCAOB rules set out specific requirements in relation to pre-approval of tax services<sup>236</sup> and non-audit services related to internal control over financial reporting.<sup>237</sup> The rules require additional information to be provided to the audit committee about the scope of the service, and on the potential effects of the services on the independence of the firm.<sup>238</sup>

### *Commentary*

235. Both frameworks require a firm to obtain concurrence or approval from TCWG/ the audit committee before a NAS/ non-audit services may be provided to an audit client. Such concurrence or approval must be obtained for each proposed NAS individually or under a general, predetermined policy agreed between the firm and TCWG/ the audit committee.
236. Arising from the different conceptual approaches, there are some differences between the approach taken by the two frameworks:
- (a) The SEC rules require the audit committee to actually pre-approve the service, while the Code requires TCWG to concur with the firm's assessments of any impact on independence and with the provision of the proposed service.<sup>239</sup>
  - (b) The SEC rules requires the accountant to seek approval before providing any audit or non-audit service. The Code requirements are applicable only to the provision of NAS.
  - (c) The SEC rules require pre-approval from the audit committee of the issuer if a service is to be provided to the issuer or its subsidiaries. Similarly, the Code requires obtaining concurrence from TCWG prior to the provision of NAS to the PIE and any subsidiaries. Additionally, the Code requires to obtain concurrence from TCWG prior to the provision of services to parent entities of that PIE.
  - (d) The SEC rules specifically address the pre-approval of services provided to investment company complexes. As the Code does not address investment company complexes, it does not include such a requirement.
  - (e) The SEC rules provide a de minimis exception to the pre-approval requirements for the provision of services other than audit, review or attest services provided that the audit committee approves the service prior to completion of the audit. The Code does not include a de minimis threshold because the IESBA concluded that the Code's provisions regarding breaches<sup>240</sup> are appropriate to address inadvertent breaches arising from the application of the requirements for firm communication with TCWG about NAS-related matters.

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<sup>234</sup> Recognizing the investment companies' complex structures, in such cases, the SEC rules limit the audit committee pre-approval responsibility to those services provided directly to the investment company and those services provided to an entity in the investment company complex where the nature of the services provided have a direct impact on the operations or financial reporting of the investment company.

<sup>235</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (7) (ii)

<sup>236</sup> Rule 3524. - Audit Committee Pre-approval of Certain Tax Services

<sup>237</sup> Rule 3525.- Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting

<sup>238</sup> PCAOB Rule 3526. Communication with Audit Committees Concerning Independence. See also paragraph 224 in this document.

<sup>239</sup> Under the corporate governance structures of some jurisdictions TCWG may not have the authority to pre-approve NAS. To allow for those situations, the Code uses the term "concurrence" TCWG, instead of "approval".

<sup>240</sup> Paragraphs R400.80 to R400.89 of the Code



- (f) In addition, the Code's provisions address a situation where the provision of information in relation to the NAS would result in disclosure of sensitive or confidential information or it would be prohibited under national laws and regulations.<sup>241</sup> Such provisions are not required where a framework – such as the SEC/PCAOB rules – has legal or regulatory standing in a particular jurisdiction.

## E. Financial Relationships

[Note: In this Section certain terms are used that include specific categories of individuals or entities, such as “entity under audit” (see paragraph 66), “covered persons” (see paragraph 75) and “accounting firm” (see paragraph 71).

### Financial Interest in the Audit Client

237. The Code prohibits the following from holding any direct or material indirect financial interest<sup>242</sup> in an audit client:

- The firm, the network firm,
- Any audit team members or any of that individual's immediate family members,
- 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
- 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.<sup>243</sup>

238. Furthermore, the Code's prohibition also applies to a financial interest in an audit client held in a trust for which the firm, network firm, or individual acts as trustee, unless:

- None of the following is a beneficiary of the trust: the trustee, the audit team member or any of that individual's immediate family, the firm or a network firm;
- The interest in the audit client held by the trust is not material to the trust;
- The trust is not able to exercise significant influence over the audit client; and
- None of the following can significantly influence any investment decision involving a financial interest in the audit client: the trustee, the audit team member or any of that individual's immediate family, the firm or a network firm.<sup>244</sup>

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<sup>241</sup> In its [Basis for Conclusions](#), *Revisions to Non-Assurance Service Provisions in the Code* the IESBA acknowledges that it does not have authority to establish requirements for TCWG, nor can it: (i) require firms or network firms to share information that is otherwise not permitted by local law or regulation; or (ii) require firms or network firms to share information that is sensitive or confidential.

<sup>242</sup> Based on paragraph 510.3 of the Code a financial interest might be held directly or indirectly through an intermediary such as a collective investment vehicle, an estate or a trust. When a beneficial owner has control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be direct. Conversely, when a beneficial owner has no control over the intermediary or ability to influence its investment decisions, the Code defines that financial interest to be indirect.

<sup>243</sup> Paragraph R510.4 of the Code

<sup>244</sup> Paragraph R510.7 of the Code

239. The Code also recognizes that a self-interest threat might be created, and requires the firm to apply the conceptual framework, if an audit team member knows that a financial interest is held in the audit client by:
- Partners and professional employees of the firm or network firm (other than those mentioned as part of the prohibition) or their immediate family members,<sup>245</sup> and
  - A close family member<sup>246</sup> or another individual with a close personal relationship with an audit team member.<sup>247</sup>
240. The SEC rules<sup>248</sup> state that “an accountant is not independent if, at any point during the audit and professional engagement period, the accountant has a direct financial interest or a material indirect financial interest in the accountant’s audit client.”
241. The SEC rules then specify that the prohibition applies where:
- An accounting firm, any covered person in the accounting firm, or any of his or her immediate family members, has any direct investment<sup>249,250</sup> (such as stocks, bonds, notes, options, or other securities) or material indirect investment<sup>251,252</sup> in an audit client.
  - An accounting firm, any covered person in the accounting firm, or any of his or her immediate family members, serves as voting trustee of a trust, or executor of an estate, containing the securities of an audit client unless they have no authority to make investment decisions for the trust or estate.<sup>253</sup>
  - Any partner, principal, shareholder, or professional employee of the accounting firm, any of his or her immediate family members, any close family member of a covered person in the firm, or any group of the above persons acquired<sup>254</sup> beneficial ownership of more than five percent of an audit client’s equity securities or controls<sup>255</sup> an audit client.
  - A close family member of a partner, principal, or shareholder of the accounting firm controls

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<sup>245</sup> Paragraphs 510.10 A9 to A12 of the Code

<sup>246</sup> Paragraphs 510.10 A5 to A8 of the Code

<sup>247</sup> Paragraphs 510.10 A9 to A12 of the Code

<sup>248</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1)

<sup>249</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (A)

<sup>250</sup> The SEC rules specify that the term direct investment includes an investment in an audit client through an intermediary if:

- (1) The accounting firm, covered person, or immediate family member, alone or together with other persons, supervises or participates in the intermediary’s investment decisions or has control over the intermediary; or
- (2) The intermediary is not a diversified management investment company, as defined by section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(b)(1), and has an investment in the audit client that amounts to 20% or more of the value of the intermediary’s total investments.

<sup>251</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (D).

<sup>252</sup> For purposes of this paragraph, the SEC rules set out that the term material indirect investment does not include ownership by any covered person in the firm, any of his or her immediate family members, or any group of the above persons of 5% or less of the outstanding shares of a diversified management investment company, as defined by section 5(b)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-5(b)(1), that invests in an audit client.

<sup>253</sup> SEC Rule 2-01 of the Commission’s Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (C)

<sup>254</sup> Filed a Schedule 13D or 13G (17 CFR 240.13d-101 or 240.13d-102) with the Commission indicating beneficial ownership

<sup>255</sup> Regulation S-X, 17 C.F.R. § 210.1-02 (g) defines the term control (including the terms controlling, controlled by and under common control with) as the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting shares, by contract, or otherwise.

an audit client.<sup>256</sup>

242. In relation to financial interest held via trustee the PCAOB Interim Ethics and Independence Standards<sup>257</sup> set out that the accountant's independence is considered to be impaired if during the period of the professional engagement a covered member was a trustee of any trust (or executor or administrator of any estate) if such trust (or estate) had or was committed to acquire any direct or material indirect financial interest in the client and
- The covered member (individually or with others) had the authority to make investment decisions for the trust (or estate); or
  - The trust (or estate) owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or
  - The value of the trust's (or estate's) holdings in the client exceeded 10 percent of the total assets of the trust or estate.

#### Commentary

243. Both the Code and the SEC rules prohibit the firm, the network firm, any audit team members/covered persons, and any of their immediate family members from holding a direct or material indirect financial interest in an audit client.
244. Although the focus is on the audit team members in the Code and covered person in the SEC rules in general, this prohibition applies, under both frameworks, to partners in the office in which an engagement partner practices in connection with the audit engagement, and certain partners or managerial employees who provide non-audit services to the audit client. However, in the case of the other prohibitions in relation to financial relationships, while the SEC's prohibitions still applies to such individuals, the Code's relevant prohibitions do not. (See also paragraph 76)
245. Both the Code and the SEC rules restrict firms, network firms, audit team members/covered persons<sup>258</sup> and any of those individuals' immediate family members from holding a financial interest in an audit client by way of a trust if they have authority to make investment decisions.<sup>259</sup><sup>260</sup> The prohibition in the Code only applies if certain additional factors apply, i.e., if the interest in the audit client held by the trust is material to the trust and/or if the relevant person is also a beneficiary of the trust.
246. Both the Code and the SEC rules go beyond the audit team and other individuals described in paragraph 237 above, or covered persons and address situations where other partners and professional employees and close family members of audit team members/covered persons hold a financial interest in the audit client:
- The Code applies a principle-based approach and requires the firm to apply the conceptual framework.
  - The SEC prohibition applies if the financial interests held exceed five percent of an audit

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<sup>256</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (B)

<sup>257</sup> PCAOB Interim Ethics and Independence Standard ET Section 101-1- Interpretation of Rule 101. A. 2.

<sup>258</sup> Given the different definitions of audit team members/covered persons under the two frameworks the scope of the prohibitions – other than those set out in paragraph R510.4 – is slightly different as explained in paragraph 76.

<sup>259</sup> Under the SEC rules this prohibition extends to being an executor of an estate.

<sup>260</sup> The PCAOB Interim Ethics and Independence Standards also prohibit, in certain situations, covered members from holding financial interest in the audit client via trust even if they have no authority to make investment decisions. See paragraph 242.

client's equity securities or control an audit client.

### **Financial Interest Held in an Entity Associated with the Audit Client**

247. Apart from the prohibitions relevant to the financial interest held in an audit client, the Code includes prohibitions regarding financial interests held in common with the audit client and in an entity controlling the audit client.
248. The Code restricts the firm, network firms, audit team members or any of that individual's immediate family members from:
- (a) Holding a direct or material indirect financial interest in an entity that has a controlling interest in an audit client and the client is material to that entity,<sup>261</sup> or
  - (b) Holding a financial interest in an entity when an audit client also has a financial interest in that entity unless:
    - The financial interests are immaterial to the firm, the network firm, the audit team member and that individual's immediate family member and the audit client, as applicable; or
    - The audit client cannot exercise significant influence over the entity<sup>262</sup>.
249. The Code requires a firm to apply the conceptual framework if a self-interest, familiarity, or intimidation threat might be created because a firm or a network firm, an audit team member, or any of that individual's immediate family members has a financial interest in an entity when a director or officer or controlling owner of the audit client is also known to have a financial interest in that entity.<sup>263</sup>
250. The SEC rules address restricting an accounting firm, any covered person in the accounting firm, or any of his or her immediate family members from:
- (a) Having any direct or material indirect investment in an entity where:
    - An audit client has an investment in that entity that is material to the audit client and has the ability to exercise significant influence over that entity; or
    - The entity has an investment in an audit client that is material to that entity and has the ability to exercise significant influence over that audit client;<sup>264 265</sup>
  - (b) Having any material investment in an entity over which an audit client has the ability to exercise significant influence,<sup>266</sup> or

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<sup>261</sup> Paragraph R510.6 of the Code

<sup>262</sup> Paragraph R510.8 of the Code

<sup>263</sup> Paragraphs 510.10 A1 to A4 of the code

<sup>264</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (E) (1)

<sup>265</sup> Based on Section IV D 1 of SEC release No. 33-7919, Revision of the Commission's Auditor Independence: "If an 'intermediary investor' or a 'common investee' becomes an affiliate of the audit client under paragraph (f)(4)(i) or (iv) [Regulation S-X, 17 C.F.R. § 210.2-01], then paragraph (E) [of Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i)] no longer governs the question of independence. Rather, paragraph (A)'s provision [in Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i)] concerning direct investments in audit clients will apply to that intermediary investor or common investee, and any investment in that entity by the firm, a covered person, or an immediate family member of a covered person would impair independence.

<sup>266</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (E) (2)

- (c) Having the ability to exercise significant influence over an entity that has the ability to exercise significant influence over an audit client<sup>267</sup>.

251. The SEC rules also prohibit the accounting firm, any covered person in the accounting firm, or any of his or her immediate family members from having any financial interest in an entity that is part of an investment company complex that includes an audit client.<sup>268</sup>

#### Commentary

252. The Code and the SEC rules contain similar prohibitions if a firm, network firm, any audit team members/covered persons, and any of their immediate family members have a financial interest in the audit client through

- An intermediary investor: The Code and SEC rules both prohibit holding a direct or material indirect financial interest in an entity if the entity has an interest in the audit client that is material to such entity.

The prohibition in the Code applies only if that entity has a controlling interest in the audit client. In contrast, SEC's prohibition applies if the entity has significant influence over the audit client, whether via controlling interest or by any other way.<sup>269</sup>

- A common investee: Both standards contain restrictions on holding a material financial interest in an entity over which an audit client has the ability to exercise significant influence.

The SEC rules also expressly prohibit holding any direct financial investment – material or not – in an entity over which the audit client can exercise significant influence and has a material investment in that entity.

253. Unlike the Code, the SEC rules also address and prohibit the accounting firm, any covered person in the firm, or any of his or her immediate family members from holding financial interests in an entity that is part of an investment company complex that includes an audit client.

#### Exceptions

254. The Code provides a relief from its prohibitions if a firm, a network firm or a partner or employee of the firm or a network firm, or any of that individual's immediate family (refer to paragraph 237) receives a direct financial interest or a material indirect financial interest by way of an inheritance, gift, as a result of a merger or in similar circumstances, provided that:

- (a) If the interest is received by the firm or a network firm, or an audit team member or any of that individual's immediate family, the financial interest is disposed of immediately (or enough of an indirect financial interest is disposed of so that the remaining interest is no longer material); or
- (b) If the interest is received by an individual who is not an audit team member, or by any of that individual's immediate family, the financial interest is disposed of as soon as possible (or enough of an indirect financial interest is disposed of so that the remaining interest is

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<sup>267</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (E) (3)

<sup>268</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (G)

<sup>269</sup> Apart from having investment in the audit client, the SEC rules also restricts from having the ability to exercise significant influence over an entity that has the ability to exercise significant influence over an audit client. [SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (E) (1)]

no longer material) and pending the disposal of the financial interest, when necessary, the firm addresses the threat created.<sup>270</sup>

255. The Code provides specific exceptions to the prohibitions applicable to immediate family members of partners in the office in which an engagement partner practices in connection with the audit engagement, or of partners or managerial employees who provide non-audit services to the audit client (see paragraph 237) if:
- (a) The family member received the financial interest because of employment rights, for example through pension or share option plans, and, when necessary, the firm addresses the threat created by the financial interest; and
  - (a) The family member disposes of or forfeits the financial interest as soon as practicable when the family member has or obtains the right to do so, or in the case of a stock option, when the family member obtains the right to exercise the option.<sup>271</sup>
256. Similar to the Code, the SEC rules also state that the accountant's independence is not deemed to be impaired if any person acquires an unsolicited financial interest, such as through an unsolicited gift or inheritance - that would otherwise cause a firm to be not independent - and the financial interest is disposed of as soon as practicable, but no later than 30 days after the person has knowledge of and the right to dispose of the financial interest.<sup>272</sup>
257. The SEC rules<sup>273</sup> include a specific exception for immediate family members of a partner, principal, or shareholder from an "office" of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit, or of a partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of non-audit services to the audit client. The accountant's independence is not deemed to be impaired if such individuals hold a financial interest that would cause an accountant to be not independent and the acquisition of the financial interest was an unavoidable consequence of participation in his or her employer's employee compensation or benefits program, provided that the financial interest, other than unexercised employee stock options, is disposed of as soon as practicable, but no later than 30 days after the person has the right to dispose of the financial interest.

#### Commentary

258. Both the Code and the SEC rules include exceptions to the prohibitions in relation to holding a financial interest in an audit client. Based on similar conditions, both SEC rules and the Code allow
- The firm, network firm, audit team member/covered person or any of their immediate family members a transition period to dispose of any prohibited unsolicited financial interests received, and
  - Immediate family members of partners who are not an audit team member / covered persons but associated with the audit engagement to hold financial interests acquired through employment rights.

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<sup>270</sup> Paragraph R510.9 of the Code

<sup>271</sup> Paragraph R510 of the Code

<sup>272</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (iii) (A)

<sup>273</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (iii) (C)

## Loans and Guarantees

259. The Code prohibits a firm, a network firm, an audit team member, or any of that individual's immediate family members from:

- (a) Making or guaranteeing a loan to an audit client<sup>274</sup>; or
- (b) Accepting a loan from, or having a borrowing guaranteed by, an audit client that is not a bank or similar institution;<sup>275</sup>

unless the loan or guarantee is immaterial to both the firm, the network firm or the individual making the loan or guarantee, as applicable, and to the client.

260. If the audit client is a bank or similar institution, the Code restricts<sup>276</sup> the firm, a network firm, an audit team member, or any of that individual's immediate family members from accepting a loan, or a guarantee of a loan, from that audit client, unless the loan or guarantee is made under normal lending procedures, terms and conditions.<sup>277</sup> Even if the loan is under normal lending procedures, terms and conditions, it might still create a self-interest threat if it is material to the audit client or to the firm receiving the loan.<sup>278</sup>

261. Furthermore, under the Code, a firm, a network firm, an audit team member, or any of their immediate family members cannot have either deposits or a brokerage account with an audit client that is a bank, broker or similar institution, unless the deposit or account is held under normal commercial terms.<sup>279</sup>

262. The SEC rules states that the accountant is not independent when the accounting firm, any covered person in the firm, or any of his or her immediate family members has a loan (including any margin loan) to or from:

- An audit client,
- An audit client's officers or directors that have the ability to affect decision-making at the entity under audit, or
- A beneficial owner (known through reasonable inquiry) of the audit client's equity securities where such beneficial owner has significant influence over the entity under audit.<sup>280</sup>

263. The following loans are exempted from the SEC prohibition if obtained from a financial institution under its normal lending procedures, terms, and requirements:

- Automobile loans and leases collateralized by the automobile;
- Loans fully collateralized by the cash surrender value of an insurance policy;
- Loans fully collateralized by cash deposits at the same financial institution;
- Mortgage loans collateralized by the borrower's primary residence provided the loans were not obtained while the covered person in the firm was a covered person; and

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<sup>274</sup> Paragraph R511.4 of the Code

<sup>275</sup> Paragraph R511.7 of the Code

<sup>276</sup> Paragraph R511.5 of the Code

<sup>277</sup> Examples of loans include mortgages, bank overdrafts, car loans, and credit card balances. See paragraph 511.5 A1 of the Code.

<sup>278</sup> Paragraph 511.5 A2 of the Code

<sup>279</sup> Paragraph R511.6 of the Code

<sup>280</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (A) (1)

- Student loans provided the loans were not obtained while the covered person in the firm was a covered person.<sup>281</sup>

264. The SEC rules prohibit an accounting firm, any covered person, or any of his or her immediate family members from

- Owing any aggregate outstanding consumer loan balance to an audit client if it is not reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period.<sup>282</sup>
- Having any savings, checking, or similar account at a bank, savings and loan, or similar institution that is an audit client, if the account has a balance that exceeds the amount insured by the Federal Deposit Insurance Corporation or any similar insurer.<sup>283,284</sup>
- Maintaining brokerage or similar accounts with a broker-dealer that is an audit client if such account includes any asset other than cash or securities and the value of assets in the accounts exceeds a certain amount, as set out in the SEC rules.<sup>285,286</sup>

Commentary<sup>287</sup>

265. The Code and the SEC rules prohibit firms, audit team members / covered persons and their immediate family members from accepting loans and making or guaranteeing loans to an audit client. However, the prohibitions under the two frameworks differ as follows:

- (a) The prohibitions in the Code only apply if the loan is material to both the firm, audit team member and immediate family member and the audit client.
- (b) The Code only prohibits accepting loans from an audit client if it is not a bank (or equivalent). (See also paragraph 266 below)
- (c) The SEC's prohibition also extends to loans from or to
  - (i) The audit client's officers or directors that have the ability to affect decision-making at the entity under audit, or.
  - (ii) The beneficial owners (known through reasonable inquiry) of the audit client's equity securities where such beneficial owner has significant influence over the entity under audit.

266. The Code allows a firm, a network firm, an audit team member, or any of that individual's immediate family members to:

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<sup>281</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (A) (1) (i)-(v)

<sup>282</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (E)

<sup>283</sup> Except that an accounting firm account may have an uninsured balance if the likelihood of the bank, savings and loan, or similar institution experiencing financial difficulties is remote.

<sup>284</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (B)

<sup>285</sup> Provided that:

- The value of assets in the accounts exceeds the amount that is subject to a Securities Investor Protection Corporation advance, for those accounts, under Section 9 of SIPA (15 U.S.C. 78fff-3); or
- With respect to non-U.S. accounts not subject to SIPA protection, the value of assets in the accounts exceeds the amount insured or protected by a program similar to SIPA.

<sup>286</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (C)

<sup>287</sup> While considering this commentary paragraph, please also see differences arising from the definition of audit team in the Code and covered persons in the SEC rules, as explained under the Section III, Key Definitions.



- Accept a loan, or a guarantee of a loan, from a client that is a bank or similar institution, if the loan or guarantee is made under normal lending procedures, terms and conditions. However, the firm still has to consider the materiality of the loan when determining the level of threats created by accepting such loans.
  - Have deposits or a brokerage account with an audit client that is a bank, broker or similar institution if it is held under normal commercial terms.
267. The SEC rules prohibit an accounting firm, covered persons, or any of that individuals' immediate family members from having:
- Any loans from any audit client, with the exception of certain specific types of loans from a financial institution obtained under its normal lending procedures, terms, and requirements (see paragraph 263 above);
  - Any savings, checking, or similar account at a bank, savings and loan, or similar institution that is an audit client above a certain threshold;
  - Any aggregate outstanding consumer loan balance owed to an audit client if it is not reduced to a specific amount, as set out in the SEC rules;
  - Accounts maintained with a broker-dealer that is an audit client if they include any asset, other than cash or securities, above a certain threshold.

#### **Other Financial Relationships with an Audit Client**

268. The SEC rules prohibit an accounting firm, any covered person in the firm, or any of his or her immediate family members from having:
- (a) Any futures, commodity, or similar account maintained with a futures commission merchant that is an audit client.<sup>288</sup>
  - (b) Any individual insurance policy issued by an insurer that is an audit client unless:
    - The policy was obtained at a time when the covered person in the firm was not a covered person in the firm; and
    - The likelihood of the insurer becoming insolvent is remote.<sup>289</sup>
269. Although the Code does not specifically address these other financial relationships with the audit client, the fundamental principles and the conceptual framework apply.

#### **Audit Client's Relationship with the Firm**

270. The SEC rules expressly state that an accountant is not independent when:
- (a) The audit client has, or has agreed to acquire, any direct investment in the accounting firm<sup>290,291</sup> 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, or
  - (b) The accounting firm engages an audit client to act as an underwriter, broker-dealer, market-maker, promoter, or analyst with respect to securities issued by the firm.<sup>292</sup>

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<sup>288</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (D)

<sup>289</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (ii) (F)

<sup>290</sup> Based on the SEC rules such investments include stocks, bonds, notes, options, or other securities.

<sup>291</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (iv) (A)

<sup>292</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (iv) (B)

271. The Code addresses this issue through the definition of network firm combined with the compliance with the fundamental principles, the conceptual framework, and the requirement that an auditor be independent of its audit client in fact and appearance.

## **F. Business Relationships**

[Note: In this Section certain terms are used that include specific categories of individuals or entities - such as "entity under audit" (see paragraph 66), "covered persons" (see paragraph 75) and "accounting firm" (see paragraph 71).

272. The Code prohibits a firm, a network firm or an audit team member from having a close business relationship with an audit client or its management unless any financial interest is immaterial, and the business relationship is insignificant to the client or its management and the firm, the network firm or the audit team member, as applicable.<sup>293</sup>
273. The Code does not prohibit a close business relationship between an audit client or its management and the immediate family of an audit team member. However, it identifies the risk that such circumstances might create a self-interest or intimidation threat and requires the firm to apply the conceptual framework.<sup>294</sup>
274. The Code provides the following examples of a close business relationship arising from a commercial relationship or common financial interest:
- Having a financial interest in a joint venture with either the client or a controlling owner, director or officer or other individual who performs senior managerial activities for that client.
  - Arrangements to combine one or more services or products of the firm or a network firm with one or more services or products of the client and to market the package with reference to both parties.
  - Distribution or marketing arrangements under which the firm or a network firm distributes or markets the client's products or services, or the client distributes or markets the firm or a network firm's products or services.<sup>295</sup>
275. The Code also prohibits a firm from having a business relationship through holding an interest in common with the audit client. The Code restricts a firm, a network firm, an audit team member, or any of that individual's immediate family from having a business relationship involving the holding of an interest in a closely-held entity when an audit client or a director or officer of the client, or any group thereof, also holds an interest in that entity, unless:
- (a) The business relationship is insignificant to the firm, the network firm, or the individual as applicable, and the client;
  - (b) The financial interest is immaterial to the investor or group of investors; and
  - (c) The financial interest does not give the investor, or group of investors, the ability to control the closely-held entity.<sup>296</sup>
276. The Code provides that the purchase of goods and services from an audit client by a firm, a

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<sup>293</sup> Paragraph R520.4 of the Code

<sup>294</sup> Paragraph 520.4 A1 of the Code

<sup>295</sup> Paragraph 520.3 A2 of the Code

<sup>296</sup> Paragraph R520.5 of the Code

network firm, an audit team member, or any of that individual's immediate family does not usually create a threat to independence if the transaction is in the normal course of business and at arm's length.<sup>297</sup>

277. The SEC rules prohibit an accounting firm or any covered person in the firm from having any direct or material indirect business relationship with:
- (a) An audit client, or
  - (b) With persons associated with the audit client in a decision-making capacity, such as:
    - An audit client's officers or directors that have the ability to affect decision-making at the entity under audit or
    - Beneficial owners (known through reasonable inquiry) of the audit client's equity securities where such beneficial owner has significant influence over the entity under audit.<sup>298</sup>
278. SEC Staff FAQ<sup>299</sup> highlighted joint ventures, limited partnerships, investments in supplier or customer companies, certain leasing interest and sales by the accountant of items other than professional services as examples of business relationships that may impair an accountant's independence. In its response to the FAQ, the SEC has recognized "that certain situations, including those in which accountants and their audit clients have joined together in a profit-sharing venture, create a unity of interest between the accountant and client. In such cases, both the revenue accruing to each party and the existence of the relationship itself create a situation in which to some degree the auditor's interest is wedded to that of its client."
279. The SEC's prohibition does not apply to a relationship in which the firm or covered person in the firm provides professional services to an audit client or is a consumer in the ordinary course of business.<sup>300</sup>

#### Commentary

280. Both frameworks include prohibitions regarding business relationships between the firm or audit team members<sup>301</sup> and the audit client or the management / persons associated with the audit client in a decision-making capacity. However, the approaches of the Code and the SEC rules differ in certain regards:
- The SEC rules prohibit any direct and material indirect business relationships. In contrast, the Code only restricts close business relationships where the financial interest is material and the business relationship is significant.
  - The restriction under the Code only includes the audit client and management, whereas the SEC restriction also captures beneficial owners of the audit client's equity securities with significant influence over the entity under audit.
281. Although the SEC rules do not specifically address business relationships created by financial interest held in common with the audit client or its management, audit firms would need to comply

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<sup>297</sup> Paragraph 520.6 A1 of the Code

<sup>298</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (3)

<sup>299</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, [D. Business relationships](#)

<sup>300</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (3)

<sup>301</sup> Please see comparison of "audit team" and "covered persons" definitions in Section III of this document

with the financial relationships requirements<sup>302</sup> (see paragraph 252) and the general standard, Rule 2-01 (b).

282. Both the SEC rules and the Code provide an exception to business relationship prohibitions in relation to the purchase of goods and services from an audit client by a firm, an audit team member/covered persons (or as a consumers under the SEC rules) in the ordinary / normal course of business.

## **G. Long Association/Partner Rotation**

### **Code's Provisions<sup>303</sup>**

283. The Code's provisions set out guidance regarding the threats to independence created where individuals from the audit team have a long association with an audit client, whether it is a PIE or a non-PIE. The Code includes specific provisions relating to audit partner rotation which are applicable to PIE audit clients, which are discussed below.

#### *Time-on Period*

284. In respect of an audit of a PIE,<sup>304</sup> the Code provides that an individual is not allowed to act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years (the "time-on" period):
- The engagement partner;
  - The individual appointed as responsible for performing the engagement quality review; or
  - Any other key audit partner role.<sup>305,306</sup>
285. As an exception to this prohibition, the Code permits key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, and with the concurrence of TCWG, serve an additional year as a key audit partner as long as the threat to independence can be eliminated or reduced to an acceptable level.<sup>307</sup>
286. The Code also provides an exception to this prohibition if the firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit, and the rotation of key audit partners might not be possible. In those cases, an individual may remain a key audit partner for more than seven years if an independent regulatory body in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances and has specified other requirements which are to be applied, such as the length of time that the key audit partner may be exempted from rotation or a regular independent external review.<sup>308</sup>

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<sup>302</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (1) (i) (E) (1) (i)

<sup>303</sup> This section refers to the [Final Pronouncements: Objectivity of an Engagement Quality Reviewer and Other Appropriate Reviewers](#) that will become effective in December 2022.

<sup>304</sup> The Code sets out different requirements and application material for long association with personnel of non-PIE audit clients that are mindful and considerate of the different level of public interest of such entities.

<sup>305</sup> See definition of key audit partner in the Code - paragraph 78.

<sup>306</sup> Paragraph 540.5 of the Code

<sup>307</sup> Paragraph R540.7 of the Code

<sup>308</sup> Paragraph R540.9 of the Code

*\*\*As of March 3, 2022 \*\**

287. Under the Code, when determining the number of years that an individual has been a key audit partner, the length of the relationship, where relevant, includes time while the individual was a key audit partner on that engagement at a prior firm.<sup>309</sup>
288. If an audit client becomes a PIE, the Code requires the firm to take into account in determining the timing of the rotation the length of time an individual has served the audit client as a key audit partner before the client becomes a PIE:
- If the individual has served the audit client as a key audit partner for a period of five cumulative years or less when the client becomes a PIE, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served.
  - As an exception to the general prohibition (see paragraph 284), if the individual has served the audit client as a key audit partner for a period of six or more cumulative years when the client becomes a public interest entity, the individual may continue to serve in that capacity with the concurrence of TCWG for a maximum of two additional years before rotating off the engagement.<sup>310</sup>

#### *Cooling-Off Period*

289. After the time-on period, the individual is required to serve a "cooling-off" period. The length of the cooling-off period depends on the previous position:
- (a) If the individual acted as the engagement partner, the cooling-off period is five consecutive years.<sup>311</sup>
  - (b) If the individual has been responsible for the engagement quality review, the cooling-off period is three consecutive years.<sup>312</sup>
  - (c) If the individual has acted as a key audit partner other than in the capacities set out above, the cooling-off period is two consecutive years.<sup>313</sup>
290. The Code specifies the required length of the cooling-off period if the individual has served in a combination of key audit partner roles, as follows:
- (a) If the individual acted in a combination of key audit partner roles and served as the engagement partner for four or more cumulative years, the cooling-off period is five consecutive years.<sup>314</sup>
  - (b) If the individual acted in a combination of key audit partner roles and served as the key audit partner responsible for the engagement quality control review for four or more cumulative years, the cooling-off period is three consecutive years.<sup>315</sup>
  - (c) If an individual has acted in a combination of engagement partner and engagement quality control review roles for four or more cumulative years during the time-on period, the cooling-off period is:

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<sup>309</sup> Paragraph R540.18 of the Code

<sup>310</sup> Paragraph R540.8 of the Code

<sup>311</sup> Paragraph R540.11 of the Code

<sup>312</sup> Paragraph R540.12 of the Code

<sup>313</sup> Paragraph R540.12 of the Code

<sup>314</sup> Paragraph R540.14 of the Code

<sup>315</sup> Paragraph R540.15 of the Code

- As an exception to point b) above, five consecutive years where the individual has been the engagement partner for three or more years; or
  - three consecutive years in the case of any other combination.<sup>316</sup>
- (d) If the individual acted in any combination of key audit partner roles other than those addressed in point (a) to (c) above, the cooling-off period is two consecutive years.<sup>317</sup>
291. For the duration of the relevant cooling-off period, the individual is not permitted to:
- (a) Be an engagement team member or provide quality control for the audit engagement;
  - (b) Consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events affecting the audit engagement (other than discussions with the engagement team limited to work undertaken or conclusions reached in the last year of the individual's time-on period where this remains relevant to the audit);
  - (c) Be responsible for leading or coordinating the professional services provided by the firm or a network firm to the audit client, or overseeing the relationship of the firm or a network firm with the audit client; or
  - (d) Undertake any other role or activity not referred to above with respect to the audit client, including the provision of NAS, that would result in the individual:
    - (i) Having significant or frequent interaction with senior management or those charged with governance; or
    - (ii) Exerting direct influence on the outcome of the audit engagement.<sup>318319</sup>
292. The Code also refers to ISQM 2<sup>320</sup> which requires a firm to establish policies or procedures that specify, as a condition for eligibility, a cooling-off period of two years before the engagement partner can assume the role of engagement quality reviewer. This serves to enable compliance with the principle of objectivity and the consistent performance of quality engagements.<sup>321</sup> However, the Code refers the cooling-off period required by ISQM 2 and clarifies that this requirement is distinct from, and does not modify, the partner rotation requirements in Section 540, which are designed to address threats to independence created by long association with an audit client.<sup>322</sup>

## SEC Rules

### *Time-On Period*

293. The SEC rules set out that an accountant is not independent of an audit client when any of the audit partners (see definition in paragraphs 78 to 79) perform:

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<sup>316</sup> Paragraph R540.16 of the Code

<sup>317</sup> Paragraph R540.17 of the Code

<sup>318</sup> Paragraph R540.20 of the Code

<sup>319</sup> The provision is not intended to prevent the individual from assuming a leadership role in the firm or a network firm, such as that of the Senior or Managing Partner (Chief Executive or equivalent).

<sup>320</sup> International Standard on Quality Management (ISQM 2), *Engagement Quality Reviews*

<sup>321</sup> Paragraph 328.8 A3 of the Code

<sup>322</sup> Paragraph 328.8 A4 of the Code

*\*\*As of March 3, 2022 \*\**

- (a) For more than five consecutive years, the services of a lead partner or the Engagement Quality Reviewer<sup>323</sup>, or
- (b) For more than seven consecutive years, one or more of the services of other audit engagement team partners
- As the "lead partner" in connection with any audit or review related to the annual or interim financial statements of a subsidiary of the issuer whose assets or revenues constitute 20% or more of the assets or revenues of the issuer's respective consolidated assets or revenues,
  - Who provide more than ten hours of audit, review, or attest services in connection with the annual or interim consolidated financial statements of the issuer or an investment company.<sup>324</sup>
294. The SEC rules provide an exception from such prohibitions for accounting firms with:
- Less than five audit clients that are issuers,<sup>325</sup> and
  - Less than ten partners,
- provided the PCAOB conducts a review at least once every three years of each of the audit client engagements that would result in a lack of auditor independence under the requirement in the above paragraph.<sup>326</sup>
295. The SEC rules do not include specific rules addressing the consideration of the period prior to the audit client becoming an entity that is subject to the SEC rules. However, in its response to an FAQ<sup>327</sup>, the SEC Staff stated that the partners are subject to the rotation requirements if the company becomes an issuer through an IPO process and the partner served at the audit client before. The FAQ explains that some filings would include three years of audited financial statements while others (e.g., certain filings by emerging growth companies) would include two years of audited financial statements. Those prior years count as prior service in determining the rotation requirements. Accordingly, both the "lead" and "concurring" partners<sup>328</sup> would have either two or three additional years before having to rotate off the engagement, depending on the number of years of audited financial statements that are included in the filing. The same conclusion would apply for determining the service time under the rotation requirements for partners other than the "lead" and "concurring" partners.
296. In another response to an FAQ,<sup>329</sup> the SEC Staff was of the view that the years a partner spent providing services to a client would also count to the rotation requirement if the partner then joins another firm and continues providing service to the same audit client.

#### *Cooling-Off Period*

297. The SEC rules prohibit any audit partner from

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<sup>323</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (6) (i) (A) (1)

<sup>324</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (6) (i) (A) (2)

<sup>325</sup> As defined in section 10A(f) of the Securities Exchange Act of 1934 (15 U.S.C. 78j-1(f))

<sup>326</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (6) (ii)

<sup>327</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, [G - Partner rotation](#), Question 2

<sup>328</sup> The revised SEC Rule 2-01 uses the term "Engagement Quality Reviewer" now, instead of "recurring partner".

<sup>329</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, [G - Partner rotation](#), Question 3

\*\*As of March 3, 2022 \*\*

- (a) Performing for that audit client the services of a lead partner, or Engagement Quality Reviewer, or a combination of those services – as of point a) in paragraph 293 - within the five consecutive year period following the performance of services for the maximum period permitted<sup>330</sup>; or
  - (b) Performing one or more of the services defined in point b) in paragraph 293 within the two consecutive year period following the performance of services for the maximum period permitted.<sup>331</sup>
298. Although the SEC rules do not include further restrictions on activities during the cooling-off period for the audit partner, in an FAQ<sup>332</sup>, the SEC Staff stated that “any time providing services to, or continuing the direct service relationship with, the issuer would not be considered as time off the audit engagement” (i.e., providing tax services or national office/technical services).
299. In relation to the objectivity of the engagement quality reviewer, the PCAOB auditing standards<sup>333</sup> set out that the person who served as the engagement partner during either of the two audits preceding the audit subject to the engagement quality review may not be the engagement quality reviewer.<sup>334</sup>

### Commentary

#### Time-on Period

300. Although only the Code includes detailed guidance regarding the broader concept of the threats to independence created by long association of audit team members with the audit client, both standards include requirements regarding audit partner rotation
301. Both the Code and the SEC rules limit the period of time an individual is allowed to serve on a key audit partner role. However, based on determination of the “audit partner”, the SEC rules on partner rotation apply to other partners, who are not covered by the Code’s “key audit partner definition”. (See paragraph 79)
302. In comparison with the SEC rules, the Code provides that the engagement partner and the engagement quality reviewer may continue for two additional years in the audit engagement:

Role	Maximum time-on in the Code	Maximum time-on in the SEC rules
The engagement partner / lead partner	7 cumulative years	5 cumulative years
Engagement Quality Reviewer	7 cumulative years	5 cumulative years
Other partners	7 cumulative years	7 cumulative years

<sup>330</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (6) (i) (B) (1)

<sup>331</sup> SEC Rule 2-01 of the Commission's Regulation S-X, 17 C.F.R. § 210.2-01 (c) (6) (i) (B) (1)

<sup>332</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, [G - Partner rotation](#), Question 7.

<sup>333</sup> PCAOB AS 1220.08

<sup>334</sup> Registered firms that qualify for the exemption under Rule 2-01(c)(6)(ii) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(6)(ii), as described in paragraph 294 of this Report.



303. Both standards allow exceptions from the requirements for partner rotation if the firm has only a few people with the necessary knowledge and experience to serve as a partner in key audit partner role. However, some of the circumstances and the conditions of the exceptions under the two frameworks are different:
- The SEC rules specify that the exception applies to firms with less than five audit clients that are issuers and less than ten partners provided the PCAOB conducts a review at least once every three years of each of the audit client engagements that would result in a lack of auditor independence.
  - The Code's exception applies only if an independent regulatory body in the relevant jurisdiction provide an exemption from partner rotation in such circumstances.
304. Furthermore, as an exception to the partner rotation requirements, the Code also allows for an additional year for key audit partners, in rare cases due to unforeseen circumstances outside the firm's control, and with the concurrence of TCWG. The SEC rules provide no such exception.
305. When determining the number of years served, both the Code and the SEC rules require consideration of periods prior to the audit client becoming a PIE/entity subject to SEC independence rules. However, there is a difference regarding how long the partner may continue in the role:
- Under the Code, all years of service spent as a key audit partner prior to the audit client becoming a PIE are counted in the total years served once an audit client becomes a PIE. The SEC's practice is that only the years a partner served during the years included in the filing count towards the maximum period.
  - The Code allows a key audit partner who has served for six or more cumulative years before the client becomes a PIE, to serve for an additional two years. There is no such exception under the SEC framework.

#### Cooling-off Period

306. Both standards restrict the activities of the rotating partners during the cooling-off period. The cooling-off period in case of the engagement partner/lead partner and other partners in key audit partner roles is the same under the two frameworks. However, the SEC rules require two additional cooling-off years for the engagement quality reviewers, as follows:

Role	Cooling-off period in the Code	Cooling-off period in the SEC rules
The engagement partner / lead partner	5 consecutive years	5 consecutive years
Engagement Quality Reviewer	3 consecutive years	5 consecutive years
Other partners	2 consecutive years	2 consecutive years

## H. Gifts and Hospitality

307. The Code prohibits a firm, a network firm or an audit team member from accepting gifts and hospitality from an audit client, unless the value is trivial and inconsequential.<sup>335</sup>

<sup>335</sup> Paragraph R420.3 of the Code

308. Based on the Code's provisions, a firm cannot accept or offer, or encourage others to accept or offer, any inducement<sup>336</sup> that the firm concludes is made, or considers a reasonable and informed third party would be likely to conclude is made, with the intent to improperly influence the behavior<sup>337</sup> of the recipient or of another individual.<sup>338</sup>
309. If a firm concludes that there is no actual or perceived intent to improperly influence the behavior of the recipient or of another individual, the conceptual framework still applies. However, if such an inducement is trivial and inconsequential, any threats created will be at an acceptable level.<sup>339</sup>
310. The SEC rules and guidance do not explicitly address the accountant or covered persons offering or accepting gifts, hospitality, or other inducements. However, in its response to a FAQ the SEC Staff <sup>340</sup> noted that the " [SEC] staff would consider all relevant facts and circumstances associated with the giving or acceptance of gifts or entertainment from an audit client in assessing whether the accountant will—or will not—be deemed independent under the general standard. The nature and frequency of the activities may reflect a close personal relationship that could be independence impairing."
311. The PCAOB Interim Ethics and Independence Standards sets out that independence would be deemed to be impaired if a covered member accepts more than a token gift from a client, even with the knowledge of the member's firm.<sup>341</sup>

#### *Commentary*

312. Both frameworks recognize that giving or accepting gifts and other inducements to or from an audit client could impact the firm's independence. The Code and the PCAOB rules both prohibit the firm or audit team members from accepting any of such gifts, unless the value is trivial and inconsequential. However, the Code includes more specific guidance and general prohibitions from offering inducements to an audit client or encouraging others to accept or offer inducement.

*To learn more about the IESBA, the Code, and the IESBA's current projects and initiatives, visit [www.ethicsboard.org](http://www.ethicsboard.org).*

<sup>336</sup> The Glossary to the Code defines inducement as an object, situation, or action that is used as a means to influence another individual's behavior, but not necessarily with the intent to improperly influence that individual's behavior. Inducements can range from minor acts of hospitality between business colleagues (for professional accountants in business), or between professional accountants and existing or prospective clients (for professional accountants in public practice), to acts that result in non-compliance with laws and regulations.

An inducement can take many different forms, for example: Gifts, Hospitality, Entertainment, Political or charitable donations, Appeals to friendship and loyalty, Employment or other commercial opportunities, Preferential treatment, rights or privileges.

<sup>337</sup> An inducement is considered as improperly influencing an individual's behavior if it causes the individual to act in an unethical manner. Such improper influence can be directed either towards the recipient or towards another individual who has some relationship with the recipient. The fundamental principles are an appropriate frame of reference for a professional accountant in considering what constitutes unethical behavior on the part of the accountant and, if necessary, by analogy, other individuals.

<sup>338</sup> Paragraphs R340.7 and R340.8 of the Code

<sup>339</sup> Paragraphs 340.11 A1 and A2 of the Code

<sup>340</sup> Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence – Frequently Asked Questions, A. General standard of independence, [Question 3](#)

<sup>341</sup> PCAOB Interim Ethics and Independence Standard ET Section 191.001-002, *Acceptance of a Gift*