

IESBA Consultative Advisory Group Report

The Public Interest Oversight Board

IESBA Consultative Advisory Group Report: 1 June 2020 – 31 August 2020

This is my fifth quarterly report submitted in the capacity as Chair of the IESBA CAG, which was effective 1 July 2019. This report covers the following topics:

Reporting Period Activities	2
Role and Mindset.....	2
Definitions of Listed Entity and Public Interest Entity (PIE).....	2
Non-Assurance Services (NAS).....	3
Fees.....	3
Engagement Team / Group Audits	3
Tax Planning.....	4
Technology.....	4
Engagement Quality Reviewer (EQR) Objectivity.....	4
eCode.....	5
CAG Membership Matters.....	5
A Final Note	5
Conclusion.....	5

IESBA Consultative Advisory Group Report

Reporting Period Activities

Meetings in reporting period:

- IESBA Board, 22 July, Virtual Meeting
- PIOB, 25-26 June, Virtual Meeting
- IESBA Board, 8-12 & 15 June, Virtual Meeting

Upcoming meetings:

- IESBA CAG, 1 & 10 September, 13 October, Virtual Meeting
- IESBA Board, 14 September & 1 October, Virtual Meeting
- PIOB, 28-30 September, Virtual Meeting
- IESBA Planning Committee, 29 & 30 October, TBD
- IESBA Board, 30 November-4 December, New York

Role and Mindset

In June, the Board approved revisions to the Role and Mindset exposure draft. Key revisions include: a renewed emphasis on PAs' responsibility to act in the public interest; enhancements to descriptions of the fundamental principles of integrity, objectivity, professional competence and due care, and professional behavior; a new requirement to have an inquiring mind when applying the conceptual framework; and new application material to highlight the impact of bias in exercising professional judgment and applying the conceptual framework. The final pronouncement has since been provided to the PIOB for approval. If approved, the final pronouncement is expected to be issued in October with an effective date of December 31, 2021, with early adoption permitted.

The CAG has addressed all significant issues with this project and the Board has followed appropriate due process necessary to issue a final standard. This project has very strong CAG support.

Definitions of Listed Entity and Public Interest Entity (PIE)

There have been ongoing calls to reconsider the listed entity and PIE definitions in the Code. In December the Board approved a project to do just that.

The PIE task force believes 1) the financial condition of PIEs should be the central focus of the PIE criteria, and 2) that when an entity is treated as a PIE there should be public transparency reporting, possibly in the audit report. I strongly support both views, also noting the final PIE criteria will directly impact red flag warnings about potential going concern failures, which are important to investors in listed entities.

The CAG will be updated and discuss this project in a joint meeting with the IAASB CAG in October and the Board will consider the CAGs input in its December meeting. Because of the public interest significance of this initiative, I have requested and am pleased to have been granted TF observer status.

One area of discussion has been whether certain non-listed entities such as public utilities should nevertheless be classified as PIEs. An argument to exclude utilities from the definition is that the market could readily replace them if they were to fail. I have been somewhat troubled with this distinction because the same argument could be made about most listed entities. Given enough time, replacement may or may not follow, but in the interim, there could be significant damage to life and property. Despite my misgivings this reasoning may be a practical expedient and resolution might be to allow local regulators to tailor concerns to jurisdictional needs. Another issue the TF is considering is to what extent the scoping definition should include related entities of PIEs.

The PIE project has broad implications to the Code, including the current IESBA NAS and Fees projects. Some concerns have been expressed about the clarity of the final PIE definitional scope prior to completing the NAS and Fees projects impacting independence. The PIE definition also has direct implications to the ISAs (e.g., EQR requirements). As the timetable stands now, it is hoped that the Board will be able to approve an exposure draft in its December 2020 or March 2021 meeting.

IESBA Consultative Advisory Group Report

Non-Assurance Services (NAS)

The IESBA approved its NAS proposal for exposure in December and the ED was issued in January with a comment period that ended in June. Since the NAS has aspects closely linked to the Fees and PIEs projects, NAS has been progressed on a coordinated basis with the other two projects. That timetable for NAS anticipates Board discussion of significant issues and CAG input in September, with hopes for final Board approval in December.

In September, the CAG will discuss significant matters arising from responses to the ED. I am particularly pleased to note the NAS task force has proposed withdrawal of all materiality factors when determining whether a NAS will create a self-review threat in relation to PIE audits. In addition, in September, the CAG will discuss benchmarking efforts to inform the Board of NAS requirements in a few jurisdictions, starting with the U.S. SEC and PCAOB.

Overall, the CAG has been very supportive of the NAS initiative. It is my view that the CAG has been appropriately engaged in the development of the NAS project throughout all of its phases and that due process in the public interest has been appropriately followed.

Fees

Fees from clients are a significant driver of behavior and have ethical consequences. Audit fees influence independence and can adversely impact public perceptions of independence.

I am pleased to report that as a result of receiving significant legal support, Board leadership appears to have resolved the issue of some U.S. Board members declining to participate in the Fees deliberations as a result of misplaced anti-trust perceptions.

In July, the Board considered a high-level summary of significant comments raised by respondents to the January Fees ED. Among other matters, the Board exchanged views on feedback relating to the self-interest threat to independence created when fees are paid by an audit client, the threshold for assessing fee dependency when an audit client is not a PIE, and public transparency about fees (i.e., reporting).

The Board will review this project at its September meeting with the aim of final approval in December. Consequently, the CAG's final input will be provided in September.

This project has strong CAG support. To date, the CAG has addressed all significant issues with this project, and it is my opinion that the Board has followed appropriate due process necessary to eventually issue a final standard.

Engagement Team / Group Audits

With the IAASB's ongoing efforts to clarify and update the provisions of group audits in the ISAs, there is also a related need to address independence requirements relevant to group audits. Of course, this requires coordination between the proposed Code and ISA definitions of engagement team (ET) and independence requirements in the context of non-network component audits. During its March meeting the IESBA approved a project to address this topic and to explore related technical issues such as these:

- The Code's independence guidance is currently silent relative to non-network component auditors that are not engaged by the group auditor
- The Code's current definition of ET applies only to audit engagements

During the March CAG meeting, it was briefed on the preliminary modifications to ISA 220 on quality control related to group audits and the IESBA's strategy to address those changes in the IIS. Preliminary CAG observations and recommendations included the following:

- Overall strong support for the project
- Aggregation risk in group audits should be considered early as an overriding issue
- Component auditor requirements are currently interspersed in the IIS. Promote a centralized approach when possible

IESBA Consultative Advisory Group Report

The CAG will be briefed as to continuing progress by the task force in its September meeting with an expectation that the CAG will review in-depth at the March 2021 CAG meeting.

Tax Planning

Much public attention has focused on aggressive tax avoidance. The CAG has consistently provided a consensus view that certain unethical tax planning activities result in tax avoidance, and those concerns need to be addressed.

In March, the CAG received a TPWG update. Then, and previously, the CAG expressed support for the direction of travel with some caveats. There is a general feeling the TPWG should be focused on evasion and not on traditional, legitimate tax planning. Also, the initiative should be kept principled-based and respect jurisdictional differences.

The TPWG continues to gather information on key issues. Unfortunately, these efforts have been somewhat frustrated due to COVID-19 communication restrictions. The TPWG has therefore postponed some planned outreach activities to Q4. As a result, the CAG will not be addressing this work stream until its March 2021 meeting.

Technology

IESBA continues to focus on ethical issues related to technology. The TTF released its Phase 1 Final Report in February focusing primarily on artificial intelligence, robotic process automation, big data and data analytics. It has now moved into Phase 2 focusing on ethics and independence implications of major trends and developments in technologies covered in Phase 1. Phase 2 activities to date have been limited to fact-finding on other technologies. This limitation is primarily a result of the COVID-19 pandemic.

In June, Board considered recommendations in the project proposal and provided directional input on possible options to address complexity threats to the fundamental principles. It also considered threats arising from new types of engagements and from the sale or licensing of technology tools.

This topic requires an evergreen dialogue due to the pace of change and linkages to the impact of technology across the accounting profession and its many stakeholders. The challenges are significant, and as previously noted, the Board is well to stay abreast of the need to raise the awareness. The CAG has expressed general support for these efforts. Privacy and confidentiality were highlighted as concerns the TTF should address early on. At its September 1st meeting, the CAG received an update and discussed Phase 2 issues.

Engagement Quality Reviewer (EQR) Objectivity

This is a fairly narrow matter but highly relevant to achieving high quality audits. The project is related and coordinated with the IAASB's current ISQM 2 project (expected for approval at the IAASB's September meeting). The focus of the IESBA in this project is on EQR objectivity (not independence).

An ED was approved by the Board in early December, subject to CAG input, which was provided in a December CAG teleconference. The focus of the call was to respond to the question of whether a "cooling off" period should be required and if so where the guidance should be included in the Code. Cooling off refers to whether a period of time out should be required to preserve objectivity, and avoid self-review risk, when an engagement partner is moved from that role to serve immediately in the EQR role.

In June, the Board considered comments received on their ED and coordination with the IAASB. Respondents expressed support for the project but also raised the issue of whether the objectivity of "appropriate reviewers" could be addressed more holistically in various roles on audits, other engagements, and in firm quality monitoring functions. This includes assignments when performing EQRs. The recommendations of the task force will be discussed at the September CAG and Board meetings.

Based on my experience in prior practice, I am convinced audit quality can be significantly improved if EQRs are effective. Whether in the Code, the ISAs or the ISQM, in order to ensure effective EQRs, the standards should not consist solely of "principles based guidance" to be interpreted and implemented by firm QC policies. There

IESBA Consultative Advisory Group Report

should be reasonable prescriptive guidance clearly directing who qualifies to perform EQRs and specifying a minimum cooling off period when an EP moves to the EQR role.

The IESBA TF force has concluded it is more appropriate to leave the prescriptive guidance to the IAASB, to avoid duplication among other matters. I do not take exception if there is an appropriate level of transparency and linkage of the basic requirement in the Code, *and as long as the complete requirements are set out elsewhere* (e.g., the ISAs or ISQMs), thereby assuring the public that EQR requirements are clear and that EQRs are being conducted objectively. In the CAG meeting on September 1st, other CAG representatives expressed similar sentiments, also noting that not all jurisdictions adopt both IESBA and IAASB standards.

eCode

Having completed the feature development work for Phase 2 and with IFAC progressing a common digital platform for all SSBs, the WG has recommended that the eCode initiative be transitioned to IFAC. Coordination will continue between the IESBA and IFAC through staff participation on IFAC's Advisory Group.

In the past the CAG has been apprised of eCode developments and has been given the opportunity to provide input. In the March 2021 meeting, the CAG will be given a general update on eCode developments including the transition.

CAG Membership Matters

Noémi Roberts (Accountancy Europe) serves on the CAG's *Membership Committee* with me. Nigel James (IOSCO) had been serving on the committee but his CAG term expired in March. This week I invited Takeshi Hirai (IOSCO) to replace Nigel on the three-person committee. Paul Munter was approved by the committee to replace Nigel as an IOSCO CAG representative in August. Paul is Deputy Chief Accountant—International Activities of the U.S. Securities and Exchange Commission. He is highly qualified in my view and has been participating in the NAS benchmarking efforts discussed above.

A Final Note

Because of COVID-19, the March and September CAG meeting agendas were significantly shortened to focus exclusively on priority matters. I had wished to discuss the following with CAG representatives in a private session:

- Reflect on what it means to participate as a CAG representative,
- Discuss whether the value of our input is commensurate with resources dedicated to CAG activities, and
- Encourage representatives to actively encourage their sponsors to step up feedback on current projects.

I still plan to cover these matters in a future meeting to re-charge the CAG commitment to provide IESBA timely and meaningful advice.

Conclusion

Projects are progressing according to the Board's work plan. With respect to the topics discussed above the CAG has been actively engaged in the best tradition of due process principles with an aim of advancing the public interest, trust, and protection.

Warmest regards,



Gaylen R. Hansen
IESBA CAG Chair