Observation Memo: IESBA

September 18-22, 2023

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Disclaimer: The observer applies his own judgement in identifying and communicating matters of public interest and due process at the meeting, and is responsible to the PIOB Technical Committee in doing so and in reporting on the observation. The view and opinion expressed in the Observation Memo are personal and belong solely to the observer and do not necessarily reflect or preclude the PIOB Board's position.

Summary of key issues from the meeting:

The IESBA meeting was held in hybrid format from September 18 to 22, 2023, at AICPA office in NYC. Three Board members (Mr. Felicien Muvunyi, Ms. Yaoshu Wu and Ms. Laurie Endsley (day1 and day2)), attended the meeting remotely. All other members, the official observers, and other attendees were present in person.

During the meeting, the draft proposals of the following standards were presented for the first read:
✔ the independence provisions for sustainability assurance engagements (WS 1)
✔ the ethics provisions for sustainability reporting (WS 2)
✔ the ethics provisions for sustainability assurance (WS 2)
✔ the ethics code on use of experts.

Also, the revisions to the exposure draft of Tax Planning and SWP were proposed for review.

The agenda was as follows:
● 2- Sustainability Common Issues
● 3- Sustainability WS1
● 4- Sustainability WS2
● 5- Strategy and Work Plan (SWP) 2024-2027
● 6- IAASB-IESBA Joint Plenary
● 7- Use of Experts
● 8- Technology (WG update)
● 9- Tax Planning

Agenda Item 2 - Sustainability Common Issues

<u>Objective of the Agenda Item:</u>
To receive a presentation from the International Accreditation Forum (IAF) and to consider sustainability-related common issues, including the proposed title of the new Part 5.

<u>IESBA Key discussion points</u>

[Presentation of IAF]
The Chair and the CEO of the IAF made a presentation on the activities of IAF, especially in the field of assurance of corporate sustainability reporting.

They presented the accreditation mechanism, their governance structure, their legal foundation (their activities are based on the WTO agreement).
Regarding sustainability assurance services, their presentation included:
✔ They published a "Joint statement" on 17 July 2023
✔ Their priority areas are: 1) consistency in accreditation activities, 2) addressing carbon MKT-related issues, and 3) standard on corporate sustainability reporting. Relating to the last point, they are currently conducting mapping and gap-finding exercise with IESBA standards and with ISSA 5000.

During the Q&A session, the following points were clarified concerning their mapping exercise:
✔ First report of the exercise will be prepared in few weeks, in time for the inter-Secretariat meeting scheduled at the beginning of October.
✔ If they decide to fill a certain gap, they have some options, including promulgating a new standard and issuing "mandatory documentation".

The Chair thanked the presentation. The Secretariat noted that the status of the inter-Secretariat discussion would be shared with the Board at the next Board meeting in December.

[Feedback on IESBA's Outreach Activities]
Regarding the feedback on outreach activities since the last meeting, it was reported that the ISO is developing "Sustainability Validation/Verification Standards" and that the IESBA staff is observing their development.
Asked about the relationship, or the overlap, between the ISO's "Validation/Verification" project and the IESBA's Sustainability projects, a IESBA staff clarified that setting the scope of the project and defining the relationship with the IESBA projects itself was a major point of discussion.

Next, "the title of the Part 5", "numbering in the Part 5" and "whether to revise the title of the entire Code" were discussed.

As for the title of the Part 5, there was broad support to the WS's proposal, "International Ethics and Independence Standards for Sustainability Assurance" .
Regarding numbering of the Part 5, there was also broad support for the WS's proposal to add a "5" before the number of the corresponding article in the extant Code (e.g. R320.01 ⇒ R5320.01) in order to ensure consistency with the current

provision.

Regarding the "title of the entire Code," the following comments were expressed both for and against the WS proposal of "not to change."

Those who support change of the title pointed out that the IAASB and IFEA do not include the word "Accountant" and that dropping the word "Accountant" facilitates acceptance of Ethical Standards by non-PAs.
On the other hand, some expressed reservations including:
✔ This is a major issue that is not limited to Part 5, but also affects Parts 1-4.
✔ Depending on the jurisdiction, legislative action may be required for the name change, and it is necessary to conduct sufficient research in advance, including the legal aspect.

It was decided that this topic would continue to be discussed in the ED or SWP.

Agenda Item 3- Sustainability WS1

<u>Objective of the Agenda Item: (Independence)</u>
Based on the inputs from the June meeting, the WS 1 made a proposal for the portion of Part 5 that formulates Independence Standards for the first read.

<u>IESBA Key discussion points</u>

[Scope of the project, ISQM1, PIE]
In the examination of the draft proposal of the WS 1, the Board first dealt with the main issues raised in the June meeting, namely the scope of the project, quality management, and the definition of the PIE.

On the scope of the project, I commented that, given that this project is designed to be profession-agnostic, the scope should be simple and accessible to non-PAs. I emphasized that it is essential that, within Part 5, the scope of WS1 and the scope of WS2 are identical, or at least well-coordinated.

On this point, the chair of the WS 1 explained:
✔ Regulators, including the EU, require that the content of the new standards be equivalent to extant IESBA standards.
✔ From the viewpoint of preventing regulatory arbitrage, the wording of standards should be the same as existing standards as much as possible.

Then the Chair summarized that the Board would continue to work on making the standards more accessible to wider stakeholders.

[Another practitioner]
This is a new issue that was not raised at the June meeting.
In Sustainability Reporting, depending on the framework of the reporting standard

which the reporting company chooses, the company may be able to incorporate sustainability information, e.g., GHG emissions, of an entity in the value chain into its own reporting. In this case, ISSA 5000 requires SAP (Sustainability Assurance Practitioners) to confirm whether it is possible to rely on the information of the value chain entity.

If the value-chain information is assured by a third party, i.e., "another practitioner", this may be relied upon and the issue for the IESBA in this case is whether to develop a standard for the independence of "another practitioner".

The proposal of the WS1 is in essence:
✔ To require the same independence between another practitioner and the value chain entity as in Part 4A.
✔ To introduce a "reason to believe" test between another practitioner and the reporting entity.
✔ To introduce a "reason to believe" test between sustainability assurance practitioner (SAP) and value chain entities.

To this proposal the Board expressed very strong hesitation and concern. The Board's comments include:
✔ Even if materiality test is applied, there may be a considerable number of value chain entities, and it is extremely onerous to conduct this procedure with them.
✔ Value chain entities may change frequently even during the reporting period, and it is difficult to identify which entity is the value chain entity in the first place.

In response to these comments, WS 1 provided the following responses:
✔ The WS 1 is aware that this may be onerous and difficult to implement, but if no independence standard for "another practitioner" is prepared, SAP will need to conduct the assurance procedure on its own to rely on the data of the Value Chain Entity, which is more onerous and unpractical. In practice, this may lead SAPs to many "scope limitations" or withdrawals.
✔ Independence is a "Yes" or "No" issue and it is difficult and inappropriate to set a lower bar. WS 1's proposal may not be practical for the time being, but the criteria should be a high bar.

In the joint session between IAASB and IESBA on Day 4, both SSBs shared the recognition that "Another Practitioner" was one of the most challenging issues in the development of sustainability related standards.
It was also noted as a top priority issue for WS 1 in the "turn around" session on Day 5.

[Other issues]
NAS, Long Association
    ✔ There was broad support for the WS 1's proposal.
Fees
        ✔ Regarding WS1's proposal that Audit fee and sustainability assurance fee should be considered separately in terms of "Fee proportion", some Board member commented that "If we look at the spirit of the Standard, both

services should be considered as common" and "it is necessary to explain the concept of the standard carefully".

[Read through].
A careful read through process was conducted, including the wording, editing and checking consistency of the criteria. The following comments were made during this process:
✔ Need to shorten sentences to make them easier to read
✔ Need to prepare flow charts and diagrams to aid understanding

In addition, there were two opinions about materials to aid understanding: "Provisions should be incorporated in the standards as much as possible" and "Since the field of Sustainability is rapidly evolving, supplementary materials should rather be made as a NAM (Non-Authoritative Material) in consideration of future revisions".

Agenda Item 4- Sustainability WS2

Objective of the Agenda Item:
To examine the WS 2's proposals of following items:
✔ Ethics Standard for Sustainability Reporting (First read)
✔ Ethics Standard for Sustainability Assurance (First read)
✔ Terms and Definitions

IESBA Key discussion points

[Ethics Standard for sustainability reporting]
Although the scope of this provision is limited to PAs, at the same time WS2 proposed to encourage non-PAs to use the code through 1) Introduction of the Standard, 2) Guideline of the Standard, and 3) Public Statement which would accompany the final announcement of the Standard. WS2 proposed a hybrid approach incorporating all three options above. This proposal received broad support from the Board.

Issues raised in the discussion of individual draft provisions include:
✔ In Sustainability Reporting field, not only Greenwashing, but also Greenhushing, Greenwishing, and other ethical issues have been pointed out, and the Standard should be applicable to these emerging issues.
✔ For PAs to encourage client companies to disclose Sustainability Information and to enhance transparency is also an important ethical issue.
✔ The content of "undue reliance" should be clarified and explained in a clear and accessible manner.

[Ethics Standard for sustainability assurance]
Regarding the scope of this project, the TF originally proposed at the June meeting, that this project cover "Part 4A type of sustainability assurance service and other engagements for the clients concerned". However, at this meeting, it was proposed to change it to cover "sustainability assurance service as a whole (not limited to Part 4A type) and other engagements for the clients concerned". This change is based on the

thinking that since Part 1 through Part 3 do not exclude Part 4B type services, it should be consistent with them.

In response to this proposal, I commented that it is difficult to understand why within the same Part 5, the scope of WS 1 is limited to Part 4A type, whereas the scope of WS 2 covers the entire sustainability assurance. It is essential that the scopes be common, or at least that they be explained in a unified manner.

This point was also noted in Day 5, and it was decided to be discussed further for the December meeting.

The following comments were made by Board members during the discussion of each provision:
✔ NOCLAR is an area that is difficult to understand, especially for non-PAs, and also difficult for PAs to implement. Standards should be as simple as possible. Guidance is needed to help understanding. Sufficient preparation period is essential before application.
✔ Regarding the application para, consideration should be given to incorporating provisions for a "second opinion".

In addition, it was raised that the revision of the Part 2 and Part 3 is discussed in the "tax planning" project in parallel. There was a question to clarify whether tax planning revision will be reflected in Part 5. On this point, WS2 responded that "it is not necessarily assumed that sustainability assurance and tax planning services are provided at the same time, but from the viewpoint of avoiding regulatory arbitrage, we would like to consider making allowances for this in Part 5 as well".

[Terms and Definition]
On the definition of "Sustainability Information", the WS2 explained that the IESBA has made considerable progress in coordinating with the IAASB, but the IESBA definition is more comprehensive and the purpose of the definition differs between ISSA 5000 and the Code of ethics.

On this, I expressed my appreciation for the significant efforts of coordination between the SSBs. I also noted that "Sustainability Information" is the most fundamental concept, and even if there remain any differences, they need to be consistent. For example, currently the word "culture" is in the IAASB's definition but not in the IESBA's, and this difference seems to be inconsistent with the explanation that the IESBA's definition is more comprehensive.

The IESBA Chair responded that (1) considerable progress has been made in reconciling the two, (2) at the same time, there is a process issue in that ISSA 5000 Exposure draft has already been issued, and (3) further reconciliation efforts are to be made.

Regarding the term "Sustainability Assurance practitioner," one Board member commented that the term could be changed to a more inclusive term such as Sustainability Practitioner in the future, while another commented that it could not be used as a definition because the "Sustainability Practitioner" does not indicate action.

It would be more appropriate to include an action such as Sustainability Assurance/Reporting practitioner.

Agenda Item 5- Strategy and Work Plan 2024-2027 (SWP)

<u>Objective of the Agenda Item:</u>
To review the comments to the Consultation Paper which was published in April 2023, and to discuss its revision proposed by the PC (Planning Committee). The SWP is to be approved at the December meeting.

<u>IESBA Key discussion points</u>
In this session, discussions were held on the following three themes:
✔ Adding "Firm Culture and Governance" to the SWP as a new project
✔ Expanding the scope of the Ethics Code to cover non-PAs
✔ Other revision to the SWP

[Firm Culture and Governance]
There was broad support from the Board for adding this theme as a new project in the SWP.
Support from the Board includes:
✔ Considering that ethical breaches are occurring in various jurisdictions, this theme needs to be addressed in an agile manner.
✔ This theme is also related to sustainability, i.e., ESG. PAs are in a position to provide ESG assurance and need to have a high bar for their own governance.
✔ This theme is also related to the "Firm-Client relationship" project, where the terminology could be changed to "Audited entity" instead of "Client," and thus we could clarify that the Audit/Assurance service is for the user.

In response to these discussions, the Planning Committee made the following comments:
✔ We would like to take these incidents as an opportunity and respond agilely.
✔ On the other hand, we do not have a concrete proposal to revise the standard at this stage. We would like to respond flexibly, including conducting research and publishing Non-Authoritative Materials in a timely manner.

[Scope of the Code]
First, the PC shared their observation that stakeholders called for the early development of an Ethics Code for non-PAs in the area of Sustainability Reporting, but similar calls have been heard in other areas, such as Tax planning and Technology-related areas, for the development of an Ethics Code that non-PAs can adopt.

For this theme, the Board expressed broad support, but also some reservations.
The following comments were made as support:
✔ Corporate reporting is currently assumed not only by PAs but also by a wide range of professions.
✔ It is clear that, due to insufficient coverage of a wide range of professions, the

current Part 2 is not fit for this purpose.
- ✔ In order for ethical standards for non-PAs to be used, the IESBA needs to find partners with which to work together on this project.
- ✔ In order to find partners, it is necessary to first create a concrete draft standard and product that could be applied by non-PAs.

At the same time, some Board members expressed their reservation that IESBA's job is to develop concrete Ethics Code provisions for accountants, and that many areas still remain to be strengthened in the current Code.

PIOB Observer's comments
I made the following comments:
- ✔ To better reflect broad stakeholders' support for developing an ethical standard on Profession-agnostic sustainability reporting, it would be appropriate to clarify in the SWP that the IESBA will develop such standards.
- ✔ On the other hand, I was not sure that stakeholders supported making the entire code of ethics profession-agnostic. To begin with, that point was not explicitly asked in the public consultation of the SWP.
- ✔ If, in finalizing the SWP, the Board intended to indicate the development of profession-agnostic ethical standards, it may be necessary to consider whether or not public consultation should be conducted again. At the very least, there should be sufficient communication with a wide range of key stakeholders, including MG and PIOB, before finalizing the SWP.

[Other issues]
The following comments were made regarding the prioritization of individual projects as indicated in the proposed SWP:
- ✔ "Communication with TCWG" is the foundation of governance, and it is not appropriate to position this project as a lower priority.
- ✔ Given the resource constraints, it is difficult to proceed with all projects even if they are positioned as high priority.
- ✔ It may be possible to make effective use of resources by broadening the scope of individual projects and focusing on the revision of standards within the scope of each project.

[Agenda Item 6 - IAASB-IESBA Joint Plenary]

Observations will be included at a later stage.

Agenda Item 7- Use of Experts

Objective of the Agenda Item:
To address ethics and "independence" considerations concerning the use of experts in both audit/assurance and non-assurance services, not limited to sustainability assurance services.

In this agenda item, the TF proposed the draft revision of Part 2 (mainly for reporting of financial information), Part 3 (mainly for audit and assurance of financial information) and Part 5 (for sustainability assurance) for the first read.

<u>IESBA Key discussion points</u>

In presenting the draft-provisions, the TF remarked that, in drafting the provisions, particular attention was paid to the boundary of whether the issue is in the field of independence or that of performance/assurance.

From the public interest point of view, the following issues were mainly discussed:
✔ Should we exclude "accounting" from the definition of "expertise"?
✔ The relationship between terms defined in the recently revised ET-GA project and those defined in this project.
✔ Whether the requirement to examine if experts are equipped with Competence, Capability and Independence, should be extended to internal experts.

Agenda Item 8- Technology (WG Update and Presentation)

<u>Objective of the Agenda Item:</u>
To share an update on the WG's activities of monitoring development of the technology landscape and the possible impacts on the Code of Ethics and to receive a presentation of Mary Breslim of Verracy, a consultation firm on data analytics.

<u>Key points of the presentation</u>
Key points of the presentation include:
✔ As technology advances, the knowledge gap in the Audit/Assurance field expands.
✔ It leads professionals to the core question, "is it ethical to rely on the tech that they do not understand?"
✔ To address this, understanding the ethical issues in each field of technology is essential.
✔ For example, for areas of AI, ethical issues include Reliability and Accuracy, Transparency, Data privacy, Professional competence and Due care, and Accountability.
✔ As for Audit/Assurance services, the operational issues are ensuring Audit trail, establishing Clear accountability protocol, Continuous data monitoring, and Bias check.
✔ With regard to Audit/Assurance services, from a viewpoint of ethics, it is critical to ensure an Audit trail, to establish a Clear accountability protocol, and to address operations such as continuous data monitoring and bias checks.

Agenda Item 9- Tax Planning

<u>Objective of the Agenda Item:</u>

To discuss the proposed amendments based on the comments to the Exposure Draft, which was published April 2023.

The key timeline of this project is as follows:
✔ December 2022: Publication of an exposure draft (ED)
✔ June 2023: Preliminary review of comments provided on the ED
✔ December 2023: Approval of the final pronouncement

IESBA Key discussion points
The main issues of the proposed amendments include:
✔ To separate the tax planning service from "related services", including tax compliance services.
✔ To remove the reference to the tax evasion from an example of tax planning and put it in the NOCLAR category.
✔ Not to require documentation of tax planning but to encourage it (no revision to the ED).

As for the separation of "related services" from the tax planning, the Board broadly supported the proposal.

On the second topic, the CAG Chair expressed a concern to the proposed amendment on the ground that it might diminish the impact of the message and I echoed to his comment. The TF chair noted that the TF would examine this point.

Regarding the documentation issue, the Board broadly supported the TF's proposal on the ground that the extant Part 3 of the Code does not have documentation requirement to remain principle-based. One Board member suggested that this issue be examined in the PIR of NOCLAR project.

PIOB Observer's Comments
I pointed out the following two public interest-related issues.
✔ The Board's should express its clear intent that the revision shall lead to actual behavioral change of the PAs.
✔ My PIOB colleagues have consistently recommended the enhancement of tax-related disclosure. I understand the Board's position that this issue is a reporting-standard issue rather than an ethical issue. Then it may be appropriate for the IESBA to consider commenting positively in the "Basis for Conclusion" on enhancement of transparency.

CONCLUDING OBSERVATION COMMENTS

I congratulated the Board for the intense and productive week in which they deeply discussed many important projects with a sharp focus on the public interest perspective.

Regarding sustainability-related projects, I noted that all the necessary building blocks were well-prepared, and major issues were thoroughly examined. Although there still

remained much work to be done, especially in terms of making all the projects more coherent and accessible, I expressed my belief that the Board took a significant step forward toward the approval of the EDs at the December meeting, as planned.

As for the SWP, I shared my observation that the IESBA was at a critical juncture as could be observed in a heated debate surrounding the "Scope of the Code". I expressed my personal thought that "expanding the Scope of the Code" and "focusing on the critical issues of PAs" was a delicate balancing act that required careful examination. Nevertheless, I expressed my respect to the Board's ambition and commitment to the public interest.

Lastly, I paid tribute to the Board and the TF for their long-lasting efforts to complete the Tax Planning project. I expressed my confidence that the goal was near and that its finalization would have a significant impact on the behavior of PAs and other stakeholders in the Tax field.

In conclusion, I reiterated my gratitude for the privilege of observing this important meeting.