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Tēnā koe Robert

SUBMISSION ON AMENDMENTS TO THE CODE OF ETHICS FOR NON-ASSURANCE SERVICES

Thank you for the opportunity to comment on Exposure Draft 2021-4, *Amendments to Professional and Ethical Standard 1: Non-Assurance Services.* We note that the standard is being amended to more closely align with the International Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (the IESBA).

We are pleased that the Board is proposing to introduce more stringent requirements than the IESBA. However, in our view the proposed changes don't go far enough.

In our view, the profession should have one set of independence requirements, set at the highest practical level. A private sector auditor should not operate at a lower standard than a public sector auditor.

Independence lies at the heart of trust and confidence in the audit profession. Without being, and being seen to be, independent the auditor simply cannot carry out their function effectively. In our view, if auditor independence is not sufficiently well protected the profession is likely to lose standing and reputation, and the public is likely to increasingly question the value of audit. In short, our position is that auditors should not be involved in non-assurance work for the entities they audit, and standards should reflect this position.

Although we acknowledge consensus building is generally important for standard setters, there are times when strong principled leadership is more important. We consider this to be one of those times.

Improving clarity and strengthening content of the Code of Ethics (the Code)

The Code issued by the Board is written for assurance practitioners. It is long and complex. In our view, assurance practitioners and any members of the public who choose to read the Code would be better served by a Code that:

- used simple and straightforward language;
- set a high standard for independence that applied equally to "independence of mind" and "independence in appearance";
- applied a single standard of independence to all entities and to all assurance engagements;
- required threats to independence (including independence in appearance) to be eliminated rather than mitigated;
- removed materiality as a factor in determining the provision of non-assurance services; and
- recognised that threats to independence can arise through events unrelated to relationships with, or interests in, the audit or assurance entity.

A high and consistent standard for independence

We agree that "appearance of independence" needs to be assessed from the perspective of a reasonable and informed third party. However, to properly apply this test, the assurance practitioner must put themselves "in the shoes" of the users of the assurance report and make their assessment based solely on publicly available information. Otherwise, the test fails.

We recommend a tighter definition of "independence in appearance":

> *The avoidance of any facts and circumstances that might cause a reasonable third party informed only by publicly available information to conclude that a firm's or an audit, review, or assurance team member's integrity, objectivity, or professional scepticism has been, or may be, compromised.*

Such a definition is similar to the notion of judicial independence; a standard to which the assurance profession should be aspiring to achieve, from a public interest perspective.

A single standard of independence for all entities and all assurance engagements

The Code applies different standards of independence based on whether the assurance engagement relates to the audit or review of financial statements of public interest entities or non-public interest entities, or other assurance.

Independence should apply to the assurance practitioner, not to the type of assurance they do. For example, applying a lesser independence standard to other assurance engagements assumes that they are less important than the audit or review of financial statements (and where relevant performance information). We do not support that assumption. For example, some assurance engagements, such as assurance over greenhouse gas emissions, may be seen to be more important than the audit or review of financial statements.

The application of safeguards

We consider that the Code would be more effective if it required the firm and the members of the assurance team to eliminate any threat to independence.

The emphasis on safeguards, in our view, is inappropriate and should be removed. Conflicts need to be eliminated, not mitigated. As Ken Hayne QC (head of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in Australia) noted

in his report "*there must be recognition that conflicts of interest and conflicts between duty and interest should be eliminated rather than 'managed'*".[1]

Removing materiality as a factor in determining the provision of non-assurance services

Materiality should not have a bearing on the decision to accept or decline a non-assurance engagement. We do not agree with a materiality "exemption" that would allow non-assurance services to be carried out for entities that are not public interest entities, or for those entities where an assurance practitioner provides an assurance engagement other than the audit or review of financial statements.

Recognising other sources of threats to independence

The Code tends to focus on relationships or interests between the audit, review, or assurance entity and the assurance practitioner. However, threats to independence can arise in other situations.

A typical example is when an audit entity is disposing of a significant business unit. A member of the assurance practitioner's network firm may be asked to act for a third party that is contemplating purchasing the business unit. The network firm will be conflicted because of its requirement to audit the vendor entity and its obligation to maximise the economic benefits to the purchasing third party.

This is a situation that threatens independence in appearance to the extent that no safeguards could effectively mitigate the threat.

In our view, the Code should alert assurance practitioners that threats to independence may arise from circumstances and events that do not directly flow from relationships with, or interests in, the audit or assurance entity.

Comment on the proposed amendments to the Code

Our responses to the questions for respondents are in Attachment 1. In Attachment 2, we have also included additional comments on other matters that came to our attention, some of which relate to the fundamental matters raised above.

I consider this a key moment in time for the XRB and the profession. Making a principled stand on independence will substantially increase the standing of the audit profession to those we are there to serve.

If you wish to further discuss any of the matters raised in this letter, please let me know. I would welcome further discussion.

Nāku noa, nā

[1] Commonwealth of Australia (2019), *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, Volume 1, Final Report, page 45.

Attachment 1 – Responses to the questions for respondents

(i) New Zealand-specific changes to tax advisory and tax planning services

Question 1. *Do you agree that the provision of tax advisory and tax planning services to an audit client that is a PIE should be prohibited? (Refer NZ R604.15 – NZ 604.15 A1)*

We note that this provision is intended to apply to audit and review clients that are public interest entities (PIEs). We agree with this change but consider that it does not go far enough. In our view, the prohibition on the provision of tax advisory and tax planning services (Part C of subsection 604 of the Code) should apply to all audit clients, review clients, and assurance clients, irrespective of whether the entity is a PIE.

The provision of tax advisory and tax planning services is in direct conflict with the audit and presents an unacceptable threat to audit independence. Tax advisory and tax planning work is intended to minimise the tax obligations on an entity. As a consequence, this work explores the boundaries of tax law and can result in arrangements that may be challenged by the tax authorities. This situation places the assurance practitioner firm in the intolerable position of justifying a tax position and advocating for the entity on one hand and in providing independent assurance on the entity's financial statements on the other. This is a clear conflict of interest and threat to independence that cannot be adequately managed by safeguards.

The threats to independence are often greater for entities that are not PIEs. Those entities place much greater reliance on the tax expertise in the firm to give them confidence that their tax affairs are in order.

Question 2. *Do you foresee any unintended consequences of this prohibition?*

A consequence of this provision is that an assurance practitioner firm that is the registered tax agent of an audit or review client will need to request the entity to find another tax agent. This is not an unintended consequence but is a necessary step to ensure the assurance practitioner firm has no association with the audit or review client in the context of managing its tax affairs.

Question 3. *Do you agree that advising an audit client in their tax return preparation or any adjustments arising therefrom is a form of tax advisory services? As such, consistent with the addition of NZ R604.15 such services would be prohibited for PIEs. (Refer NZ 604.11 A1)*

We agree that advising an audit client in their tax return preparation or any adjustments arising therefrom (Part A of subsection 604 of the Code) is a form of tax advisory service. We note that this interpretation is limited to audit and review clients that are PIEs. As stated above, our view is that the prohibition on the provision of tax advisory and tax planning services should apply to all audit clients, review clients, and assurance clients, irrespective of whether the entity is a PIE.

The proposed Code allows an assurance practitioner to enter into engagements that are "related to the audit or review engagement" (para NZ600.14 A1). This would permit the assurance practitioner to engage with the audit client, review client, or assurance client to audit or review the tax return they have prepared for filing with the tax authorities.

The assurance practitioner needs to exercise considerable caution before they accept such engagements. They may unwittingly assume a management responsibility if the entity does not have personnel with the necessary understanding and experience of the applicable tax law to prepare a credible tax return. We suggest that the risk of assuming management responsibility is high in the context of auditing or reviewing tax returns prepared by the entity, and the Code should specifically draw attention to R600.7 of the Code, which prohibits an assurance practitioner from assuming management responsibility.

Question 4. *Are there any other tax services contemplated by proposed subsection 604 for which you consider the requirements should be further strengthened and, if so, why?*

We find it difficult to understand why the prohibition on the provision of tax advisory and tax planning services should be limited to audit and review clients that are PIEs. The independence threats apply equally, if not to a greater extent, to audit clients, review clients, and assurance clients that are not PIEs. Limiting of the prohibition to audit and review clients that are PIEs reveals an inconsistency in the application of independence in the Code, from both an application perspective and from a public understanding perspective, because the Code should set a single standard for independence across all entities and for all assurance engagements.

In addition, we are of the view that prohibitions should be extended to tax calculations for the purpose of preparing accounting entries (Part B of subsection 604 of the Code), to tax services involving valuations (Part D of subsection 604 of the Code), and to assistance in the resolution of tax disputes (Part E of subsection 604 of the Code). These prohibitions should apply to all audit and review clients and to all assurance clients.

(ii) Any other Non-assurance services

Question 5. *The NZAuASB has not identified any further aspects of the IESBA's provisions that need to be strengthened in New Zealand. We are, however, keen to hear whether stakeholders consider there is a need to further strengthen any specific provisions.*

In principle, assurance practitioners should not be permitted to provide nonassurance services to audit clients, review clients, and assurance clients, irrespective of whether they are PIEs.

However, we consider that assurance practitioners should be able to assist a unique group of small entities, which we describe as "micro-entities", to compile simple financial statements in accordance with the applicable financial reporting framework. Compilation involves using information derived from the entity's trial balance or underlying records. Such a service would be permitted only when the entity does not have access to personnel with the knowledge to prepare the financial statements and does not have the financial resources to engage the necessary personnel. In this situation overall accountability is served because financial statements would not be prepared by these entities without the assurance practitioner's assistance.

Apart from "compilation" engagements, additional engagements carried out by assurance practitioners should be limited to "work of an assurance nature".

A deficiency in the Code is that it does not acknowledge the threats to independence when assurance practitioners enter into engagements with third parties that are unrelated to audit clients, review clients, and assurance clients. Such engagements can threaten independence in appearance.

(iii) Audit-related services

Question 6. *Do you agree that additional services performed by the audit firm will generally not create a self-review threat to the firm's independence when the services are related to the audit engagement?*

It is the nature of the additional services that will determine whether a threat to independence arises, recognising that the threat is not necessarily limited to a self-review threat. The heading preceding 600.1 refers to "non-assurance services". It follows that any service that falls outside this description is an "assurance engagement". And the description "assurance engagement" captures the nature of an additional service that is very unlikely to threaten the independence of an assurance practitioner.

The description "audit-related service" is described as one that is related to the audit engagement. Without reading further, a service that is related to an audit engagement could be construed as any form of work (both assurance and nonassurance in nature) that directly relates to the subject matter of the audit. In an audit of financial statements such engagements could include valuations, the design and implementation of internal control systems, reconciliations, preparation of financial statements, and so on. In our view, the description of a service as "related to the audit" does not capture the nature of those services that would not threaten the independence of the assurance practitioner. However, "assurance" does describe the nature of a service that is unlikely to threaten independence and that is why the Auditor-General has chosen the term "work of an assurance nature". In the Auditor-General's independence requirements "work of an assurance nature" is defined more broadly than the narrow specification of "assurance engagement" in the glossary in the Code.

Question 7. *Do you agree that the examples listed would not generally create a self-review threat to independence? Are there other types of services, that would generally not create a self-review threat to independence, that you consider need to be included as examples? (Refer NZ 600.14 A1)*

We agree that the examples of engagements listed in NZ 600.14 A1 would generally not create a threat to independence. Other engagements that would complement the audit but that would not necessarily require the assurance provider to express an opinion might include:

- independent quality assurance of a project assessed against a generally accepted standard;
- reviews over the probity of processes;
- observation of the integrity of voting procedures;
- in-depth examination of processes or internal control systems that wouldn't normally be considered as part of the financial statement audit; and •
  effectiveness and efficiency audits.

Question 8. *Do you agree that the additional application material emphasising the need to apply the conceptual framework to identify, evaluate and address threats to independence, other than the self-review threat, is helpful to ensure diligent application of the conceptual framework? (Refer NZ 600.14 A1)*

We agree that the additional application material in NZ 600.14 A1 that emphasises the need to apply the conceptual framework to identify, evaluate, and address threats to independence, other than the self-review threat, is helpful to ensure diligent application of the conceptual framework. We make this comment while observing that the Code should be formulated to address the fundamental concerns expressed in the covering letter.

Question 9. *Do you consider additional requirements or application material is needed in relation to audit-related services, to address perceptions of auditor independence? If yes, please provide details.*

As noted in our covering letter, in our view the independence requirements of the Code are too complex to give the public confidence that assurance practitioners are independent in both fact and appearance.

(iv) Effective Date

Question 10. *For engagements entered into before 15 December 2022, for which work has already commenced, the transitional provision provides that the firm may continue the engagement under the extant provisions of the Professional and Ethical Standard 1 for up to 12 months. Do you agree with the transitional provision? If not, please explain why not and what alternative you propose.*

We agree with the transitional provisions.

Attachment 2 – Additional comments on the proposals

As well as the matters raised in the covering letter and in Attachment 1, we have a number of detailed comments on the Exposure Draft as set out below.

Paragraph	Comment
Paragraph 11 of the invitation to comment	The invitation to comment correctly observes that independence in appearance is critical; irrespective of whether the entity is a PIE. However, the Board intends to adopt the revised IESBA provisions that are limited to prohibiting assurance practitioners from accepting certain non-assurance services that might create a self-interest threat for audit or review clients that are PIEs. In addition, there is a specific prohibition on the provision of tax advisory and tax planning services for audit and review clients that are PIEs. The proposals do not adequately address independence in appearance, in that: • they do not directly respond to the application of the “reasonable third party” test. For example, the safeguard of using professionals who are not audit or review team members to perform the service does not safeguard independence in appearance; and • the proposals do not apply to audit or review clients that are not PIEs, or to assurance clients.

R600.14	This requirement specifies the process that the assurance practitioner should follow to determine whether a non-assurance service can be carried out for an audit or review client that is not a PIE, where the service might create a self-review threat. If the Code is also intended to give the public confidence that assurance practitioners are independent (as we consider it should), this is an example of the complexity in the Code that fails to give that confidence. In addition, the assessments in (a) and (b) of R600.14 enable the assurance practitioner to examine the nature of the non-assurance engagement in minute detail and determine whether the results of the engagement will be encountered as part of the audit or review. A sceptical person might conclude that R600.14 is designed to allow fine adjustments to be made to the scope of the non-assurance engagement so that it is permitted under the Code.
R600.25	We note this requirement does not contain a "shall" statement.
R600.26(c)(iv)	This is a condition requiring the firm to address other threats created by providing such services that are ***not*** at an acceptable level. Should the "not" be removed?

Paragraph	**Comment**
601.5 A2	This paragraph gives examples of "accounting and bookkeeping services" that might be regarded as routine or mechanical in nature and that might be carried out by an assurance practitioner for audit or review clients that are not PIEs. The fact that processes may be routine or mechanical is not a reason for permitting an assurance provider to carry out these services for the entity they are required to audit or review. These are processes over which the assurance practitioner is required to express an independent opinion. That an assurance provider, for example, is permitted to prepare payroll calculations stretches the credibility of the independent assurance they are required to provide. The one exception, in our view, relates to carrying out compilation engagements in the unique circumstances described in our response to question 5 in Attachment 1.
Subsection 604 generally	In our view, the Code should prohibit assurance practitioners from entering into any form of tax service with the entity, as described in A, B, C, D and E of subsection 604. The prohibition should apply to all audit clients, review clients, and assurance clients irrespective of whether the entity is a PIE. The threats to independence arising from tax services are so significant that they should not be accepted. Furthermore, mitigations cannot be applied to reduce the independence threats to an acceptable level.
604.22 A1	This paragraph states that a factor to be taken into account in identifying self-review or advocacy threats created by assisting an audit or review client in the resolution of tax disputes is whether the proceedings are conducted in public. It suggests if a dispute can be resolved "behind closed doors" then that lessens the threat to independence. Public confidence in assurance practitioners is diminished if a lack of transparency in process is seen as a mitigating factor in deciding whether non-assurance services can be accepted.

605.2 A2	There is a comment in this paragraph that suggests if internal audit involves matters that are "operational in nature" they do not necessarily relate to matters that will be subject to consideration in relation to the audit or review of the financial statements and can be accepted. This statement conveys a very narrow view of the purpose of the financial statements which, in part, is to fairly present the financial consequences of an entity's operations. We suggest that assurance practitioners becoming involved in matters that are operational in nature does not automatically reduce the threats to independence from the perspective of the external auditor.
R610.6	This requirement sets out a two-step process to be followed when deciding whether advice in relation to corporate services can be provided. The process requires that both steps need to be considered through the use of the connector "and". However, in our view, if the advice depends on a particular accounting treatment or presentation in the financial statements (the first step) then that is a sufficient basis for not accepting the engagement because it presents an unacceptable threat to independence.

Paragraph	**Comment**
605.5 A1, 606.6 A1 607.7 A2 607.8 A1 608.6 A1 608.10 A1 609.4 A4 610.7 A1 610.8 A1 900.32 A1	We have a concern that some of the safeguards in the Code are focused solely on mitigating threats to "independence of mind", but do little to mitigate threats to "independence in appearance". These paragraphs refer to the safeguard of using professionals who are not audit or review team members to perform non-assurance services. This safeguard does not satisfy the test of the reasonable third party informed only by publicly available information. The users of assurance practitioners' reports tend to view non-assurance services as an indicator that a firm may be compromising the quality of the assurance engagement.
	As stated in our covering letter, we also encourage the consideration of several fundamental matters. In our view, assurance practitioners and any members of the public who choose to read the Code would be better served by a Code that: • used simple and straightforward language; • set a high standard for independence that applied equally to "independence of mind" and "independence in appearance"; • applied a single standard of independence to all entities and to all assurance engagements; • required threats to independence (including independence in appearance) to be eliminated rather than mitigated; • removed materiality as a factor in determining the provision of nonassurance services; and • recognised that threats to independence can arise through events unrelated to relationships with, or interests in, the audit or assurance entity.