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submitted electronically through the IESBA website

Re.: Exposure Draft: Proposed Revisions to the Non-Assurance Services Provisions of the Code

Dear Ken,

We would like to thank you for the opportunity to provide the IESBA with our comments on the Exposure Draft "Proposed Revisions to the Non-Assurance Services Provisions of the Code", hereinafter referred to as "the Exposure Draft".

As you are aware, the IDW previously expressed specific concerns in a letter to yourself and Stavros dated 5th September 2019. We note that certain of our concerns have been addressed in part or in whole, although we remain concerned as to certain matters, including the proposal to no longer include materiality considerations in the assessment of the perceived threat certain NAS might pose to auditor independence and the provision of specific tax related NAS as outlined in the appendix to this letter.

Before addressing in the appendix to this letter some of the individual questions raised in the Explanatory Memorandum, we provide some general comments on the proposals contained in the Exposure Draft, some of which are not subject to specific questions.

We have chosen not to respond to the request for general comments as any issues we have from the perspective of small and medium practices are already included in our comments. We have not considered translation issues, as the German Wirtschaftsprüferkammer (WPK) would generally undertake any translation into German. Other perspectives are not relevant to the IDW.

Impact of the current Covid-19 pandemic on this project

We appreciate the sensitivity IESBA has recently demonstrated in extending the deadline for comments. Regarding this project, there are two aspects we suggest need further discussion by IESBA.

Firstly, the ongoing Covid-19 pandemic has all too clearly demonstrated the need not to deny those entities in need of urgent advice at various stages from obtaining this from their auditor. An auditor's knowledge of a client's business and environment may often be key in facilitating the timely, complete, and bespoke advice that will be essential in this time of crisis. For many entities obtaining support as quickly as possible may be essential to their survival. For auditors of PIEs, the outright ban on NAS that create a self-review threat for PIEs is potentially problematical in this context, especially smaller PIEs. We urge the IESBA in tightening the "package" of requirements aimed at safeguarding auditor independence to be highly sensitive to this.

Secondly, we believe that the pace of change to the IESBA Code (and – for Germany – any corresponding national alignment initiatives) auditing firms are required to deal with needs to slow down considerably. In determining the effective date, we would urge the IESBA to bear in mind that the strain caused by the current crisis also affects firms and to defer the effective date appropriately.

IESBA's mandate does not extend to multi-disciplinary business models

We note the discussion in the Explanatory Memorandum concerning IESBA's role in relation to firms' multi-disciplinary business models whereby firms often provide audit services together with consulting and advisory services to a wide range of clients.

The IDW firmly agrees with IESBA's contention that such concerns are beyond the Board's mandate.

We note the discussions in various parts of the world as to multidisciplinary firms but are convinced that this model remains appropriate in today's increasingly complex environment – not least, to ensure firms do not lose their current access to the appropriate expertise necessary to safeguard quality audit.

Cost-benefit considerations in proposing onerous requirements

The IDW has consistently supported the IESBA in taking a principles-based approach in its Code.

We are increasingly concerned that without either providing evidence for the need to tighten rules or sufficient regard to the associated practicalities and cost-benefit implications, the IESBA seeks to have auditors "prove" their independence – and for PIEs this is often primarily independence in appearance. Auditors are thus required to perform detailed work that often involves arduous information gathering in complex and geographically spread-out group situations and consequently additional documentation.

The notion of independence in appearance seems to be increasingly used as a "carte blanche", justifying the introduction of ever increasingly stringent and rules-based measures in the PIE audit arena that have little to do with the actual impact on the independence of mind of an auditor. Indeed, the explanations in agenda papers are often cited as IESBA's views, but lack any firm evidence.

In our view, IESBA ought to consider the real impact on auditor independence of mind of proposals in a more holistic manner rather than focusing overly on views of some stakeholders or individual IESBA members about deemed perceptions of appearances, which by nature are highly subjective. Indeed, for an effective IESBA Code designed for global application, the IDW has consistently supported a principles-based approach, and consequently is concerned about the sharp increase in proposals that seek to introduce rules and finite criteria, often similar to those in place in particular jurisdictions (including the EU). Clearly where such proposals reflect legislative measures that already apply in Germany, we will not take issue on specific measures: Nevertheless, we are increasingly concerned as to the appropriateness of rules in the absence of evidence-based justification within a globally applicable Code that still purports to be principles-based.

We urge the IESBA to be sensitive to practicalities and the cost-benefit implications of its proposals, as appropriate.

The term "Public Interest Entity"

We note that IESBA has accelerated its work on a project concerning the definition of the term "Public Interest Entity (PIE)", but that this has not yet been finalized.

The absence of a firm notion of which entities will be covered by the term PIE, means that it is unreasonable to expect stakeholders to comment in a fully-informed manner on this ED, as there could be issues for certain entities that cannot yet be envisaged.

Equally concerning is the fact that IESBA has itself made key decisions impacting all auditors who serve audit clients that are PIEs without certainty as to what constitutes a PIE under the Code and without due regard for the divergences between entities that may constitute PIEs according to laws and regulations in different jurisdictions.

In addition, the IDW remains concerned that without very clear persuasive justification, the stark differentiation between audit clients that are PIEs and those that are not will drive a wedge in the audit market. There is a distinct danger that bans on the permissibility of NAS to audit clients that are PIEs may –over time – lead to a trickle-down effect, certainly as far as larger SMEs that are non-PIEs are concerned, irrespective of the IESBA's intent.

Provisions relevant to NAS previously provided to potential audit clients that are PIEs

The IESBA is proposing revision of the safeguards to address the situation where a previous NAS provided to a PIE might preclude an auditor from accepting an audit engagement.

Since restrictions on changing auditor potentially have a significant impact on concentration in the audit market, we fully agree that an appropriate safeguard regime is needed.

We do not take issue with the proposal that cessation of the service coupled with the results thereof having been subject to auditing procedures by the predecessor audit firm as proposed in R400.32 (a) is appropriate.

However, IESBA is also proposing that certain of the extant Code's safeguards in this context be deleted. Specifically, these include using non-audit team members to provide the particular service, or to perform an appropriate review of audit and NAS.

IESBA proposes replacing the requirement for such work to be performed by non-audit team members with work by a firm or service provider from outside the potential incoming auditor's firm or network (see proposed paragraph R400.32 (b) and (c)). Given the lack of any apparent gain in terms of engagement quality for the client coupled with an increase in costs, we question

whether this change is warranted in every case and whether this option would be used in practice. We suspect that the safeguards proposed in paragraph R400.32 (b) and (c) will not gain full client acceptance and may well serve to disadvantage some firms (often SMPs) from being engaged as auditor in the PIE audit market.

We are not aware of any evidence that a similar safeguard in the extant Code has been widely used. In our opinion, practicalities do need to be considered in designing appropriate, effective safeguards in this context, if the Board does not (unintentionally) intend to exacerbate the concentration in the PIE audit market.

We would be pleased to provide you with further information if you have any additional questions about our response, or to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Sebastian Kuck
Director, European Affairs

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Appendix

Request for Specific Comments

Prohibition on NAS that Will Create a Self-review Threat for PIEs

1. *Do you support the proposal to establish a self-review threat prohibition in proposed paragraph R600.14?*

No. This proposal constitutes a blanket ban and is a radical change from the extant Code for audit clients that are classified as PIEs, which – for a Code designed for global application – we contend demands clear and persuasive justification.

IESBA has provided no real evidence in support of the general statement in paragraph 600.13 A2: "Where the provision of a non-assurance service to an audit client that is a public interest entity creates a self-review threat, that threat cannot be eliminated, and safeguards are not capable of being applied to reduce that threat to an acceptable level". Indeed, we note that IESBA's agenda papers mention "IESBA Members' views" or "views of some stakeholders" in this context.

As we explain in the attached covering letter, the notion of independence in appearance seems to be increasingly used as a "carte blanche" to justify the introduction of ever increasingly stringent and rules-based measures in the PIE audit arena that have little to do with the actual impact on the independence of mind of an auditor.

We would urge IESBA to consider the real impact on auditor independence of mind of proposals in a more holistic manner, rather than focusing overly on views about deemed perceptions of appearances, as by nature both views and perceptions are highly subjective.

We believe the Code's third-party test would be appropriate in this context. Indeed, a reasonable third party weighing up the facts and circumstances of an individual case might well sometimes concede that a no-tolerance approach is excessive were he or she to take factors such as e.g., the benefits of a particular NAS being supplied by the auditor (e.g., resulting from in-depth knowledge of the entity) and the magnitude (e.g., measured in terms of financial statement materiality) of the impact of providing the particular NAS on independence of mind into account in weighing the threat in an individual case up against the strength of possible safeguard(s). In our response to q. 7 below,

we also express our support for the advance concurrence of TCWG for the engagement of the auditor to perform an NAS as a strong safeguard.

We also question whether the apparent focus on "independence in appearance" currently seen in some jurisdictions is appropriate in respect of all PIEs worldwide, especially since – as also mentioned in our cover letter – the Board is not responsible for the determination of what constitutes a PIE in all jurisdictions around the world, nor has it reached a final decision on what that term shall mean within the Code.

2. *Does the proposed application material in 600.11 A2 set out clearly the thought process to be undertaken when considering whether the provision of a NAS to an audit client will create a self-review threat? If not, what other factors should be considered?*

The thought process is set out sufficiently clearly, although as explained in our response to q. 1 above and to 5 below, we believe that the proposed deletion of materiality (as presented in paragraph 600.5.A1 of the extant Code) is not justified.

Providing Advice and Recommendations

3. *Is the proposed application material relating to providing advice and recommendations in proposed paragraph 600.12 A1, including with respect to tax advisory and tax planning in proposed paragraph 604.12 A2, sufficiently clear and appropriate, or is additional application material needed?*

Including a consideration of "how such advice and recommendations might be implemented by the audit client" in proposed paragraph 600.12 A1 ahead of a decision on whether to provide specific advice or recommendations will require the auditor not only to second guess the client's decision, but also to know the full extent of the advice or recommendation. In our view this will not be practicable in many cases.

In regard to proposed paragraph 604.12 A2: we note that:

> "(c) have a basis in tax law and regulation that is likely to prevail"

is preferable to certain previous thresholds discussed by the Board. However, we are still concerned from a practical viewpoint, that this threshold may not actually work as intended if it is to be applied in jurisdictions such as Germany.

We are primarily concerned that this proposed change may contravene Germany's legal principles in so far as they impact the right of professional accountants to exercise their profession in Germany. Furthermore, rendering incomplete tax advice (i.e., withholding advice on an option) would mean a practitioner facing a liability claim for any loss to a client if an option that had been withheld later proved to have been a viable option. Practitioners in Germany are required to set forth all potentially viable options and advise on their likelihood of being permitted, as well as their pros and cons, since ultimately it has to be the clients who make all decisions concerning their individual tax affairs and constitutionally they have a right to minimize their tax liabilities within the confines of the law. Therefore, the proposed threshold still appears problematic in Germany in practical and legal terms.

We would also ask the Board to bear in mind that a relatively low threshold will also likely drive over-conservatism in tax services provided by auditors as opposed to other (i.e., non-audit professionals) who provide tax services, thus clients may turn away from members of our profession to others which, in the longer term, may not be in the public interest.

In our view, a solution such as that currently used in Germany, as described briefly above, resulting in tax services that offer full transparency accompanied by recommendations may be a more palatable solution.

Project on Definitions of Listed Entity and PIE

4. *Having regard to the material in section I, D, "Project on Definitions of Listed Entity and PIE," and the planned scope and approach set out in the approved project proposal, please share your views about what you believe the IESBA should consider in undertaking its project to review the definition of a PIE.*

We refer to the comments in the attached cover letter in this respect.

The IDW is following the IESBA's PIE definition project closely and plans to comment on this in detail in due course.

Materiality

5. *Do you support the IESBA's proposals relating to materiality, including the proposal to withdraw the materiality qualifier in relation to certain NAS prohibitions for audit clients that are PIEs (see Section III, B "Materiality")?*

No. We refer to our response to q. 1 and 2 as well as our comments in our cover letter.

As IESBA is aware, German audit firms are amongst the firms throughout Europe who have been subject to a ban on certain on-audit services for audit clients that are PIEs as defined in EU legislation under the so-called blacklist[1] introduced by the EU Audit Regulations for PIEs in the European Union, which came into force mid-2016. Under this regulation certain exceptions may be made at Member State level, which can then include consideration of materiality and specific safeguards. The exceptions regarding certain tax services and evaluation services have been incorporated in German law.

As summarized below, the ED includes proposals for the deletion of "the extent to which the outcome of the service will have a material effect on the financial statements" for all audit clients in relation to:

- Tax Advisory and Tax Planning Services (R604.13)
- Litigation support services (607.4A1)
- Corporate finance and transaction advisory services (R610.6).

And for audit clients that are PIEs the proposed restriction would apply either from proposed deletions, or from the proposed introduction of new requirements, which similarly do not refer to materiality. The following NAS are affected:

- Valuation services (R603.5)
- Preparing tax calculations of current and deferred tax (R604.10)
- Tax advisory and tax planning services (R604.15)
- Assistance in the resolution of tax disputes (R604.24 and R604.26)
- Internal audit services (R605.6)
- Information systems services (R606.6)
- Litigation support services (R 607.6)
- Legal advisory services (R608.6)
- Advocacy role (R608.9)
- Corporate finance and transaction advisory services (R610.8).

Without any real justification by IESBA, we are at a loss to understand the need for stricter requirements internationally. As explained in our response to q. 1, we contend that the Code's third-party test would take magnitude into account.

[1] Ref Article 5 of the Regulation
https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0537&from=EN

6. *Do you support the proposal to prohibit the following NAS for all audit clients, irrespective of materiality:*
   - *Tax planning and tax advisory services provided to an audit client when the effectiveness of the tax advice is dependent on a particular accounting treatment or presentation and the audit team has doubt about the appropriateness of that treatment or presentation (see proposed paragraph R604.13)?*
   - *Corporate finance services provided to an audit client when the effectiveness of such advice depends on a particular accounting treatment or presentation and the audit team has doubt about the appropriateness of that treatment or presentation (see proposed paragraph R610.6)?*

No. For the reasons explained above, we are against these proposals for all audit clients, as we believe that materiality is a factor that needs to be taken into consideration. We refer to our response to q.5.

Communication with TCWG

7. *Do you support the proposals for improved firm communication with TCWG (see proposed paragraphs R600.18 to 600.19 A1), including the requirement to obtain concurrence from TCWG for the provision of a NAS to an audit client that is a PIE (see proposed paragraph R600.19)?*

Yes. We support this approach.

We also believe that concurrence of an audit committee or equivalent body (such as the supervisory board in Germany) is a safeguard that should apply to all NAS, since such body would be in a suitably informed position to weigh up the benefit of engaging the auditor to perform a particular NAS and the level of any threat that service might pose to auditor independence.

Other Proposed Revisions to General NAS Provisions

8. *Do you support the proposal to move the provisions relating to assuming management responsibility from Section 600 to Section 400, and from Section 950 to Section 900?*

Yes.

9. *Do you support the proposal to elevate the extant application material relating to the provision of multiple NAS to the same audit client to a requirement (see proposed paragraph R600.10)? Is the related application material in paragraph 600.10 A1 helpful to implement the new requirement?*

Yes.

Proposed Revisions to Subsections

10. Do *you support the proposed revisions to subsections 601 to 610, including:*

- *The concluding paragraph relating to the provision of services that are "routine or mechanical" in proposed paragraph 601.4 A1?*

We support the concluding paragraph relating to the provision of services that are "routine or mechanical" in proposed paragraph 601.4 A1.

- *The withdrawal of the exemption in extant paragraph R601.7 that permits firms and network firms to provide accounting and bookkeeping services for divisions and related entities of a PIE if the certain conditions are met?*

In our view the current safeguards are not problematical, and we do not see a need for the proposed withdrawal of the exemption in extant paragraph R601.7 that permits firms and network firms to provide accounting and bookkeeping services for divisions and related entities of a PIE if certain conditions are met.

- *The prohibition on the provision of a tax service or recommending a tax transaction if the service or transaction relates to marketing, planning or opining in favor of a tax treatment, and a significant purpose of the tax treatment or transaction is tax avoidance (see proposed paragraph R604.4)?*

We appreciate the intention behind the proposed prohibition on the provision of a tax service or recommending a tax transaction if the service or transaction relates to marketing, planning or opining in favor of a tax treatment, and a significant purpose of the tax treatment or transaction is tax avoidance.

However, we remain concerned that this aspect of the proposed changes may contravene Germany's legal principles in so far as they impact the right of professional accountants to exercise their profession in Germany. Furthermore, rendering incomplete tax advice (i.e., withholding advice on an option) would mean a practitioner facing a liability claim for any loss to a client if an option that had been withheld later proved to have been a viable option. Practitioners in

Germany are required to set forth all potentially viable options and advise on their likelihood of being permitted, as well as their pros and cons, since ultimately it has to be the clients who make all decisions concerning their individual tax affairs and constitutionally they have a right to minimize their tax liabilities within the confines of the law. We note that tax evasion is illegal, tax minimization is not illegal, whereas what constitutes tax avoidance is potentially open to various interpretations. Therefore, the proposed moral threshold: "a significant purpose of the tax treatment or transaction is tax avoidance" appears problematical in Germany in practical and legal terms.

We refer to our comments in response to q. 3 above in regard to the proposed threshold "basis in applicable tax law and regulation that is likely to prevail".

Furthermore, including this paragraph at this point in time would also partially pre-empt the outcome of the IESBA's ongoing project on tax services.

On balance we would urge the Board to refrain from including this requirement and section at this point in time and to defer its consideration until such time as its project on tax advisory services is able to address the issue thoroughly and in context of the Code in total.

- *The new provisions relating to acting as a witness in subsection 607, including the new prohibition relating to acting as an expert witness in proposed paragraph R607.6?*

We refer to our response to q.5 regarding the requirement to disregard materiality in the context of an audit client that is a PIE.

Proposed Consequential Amendments

11. Do you support the proposed consequential amendments to Section 950?

We refer to our comments in response to q. 1 above in regard to the third-party test and support the acknowledgement in proposed paragraph 950.9 A1.

We suggest IESBA also explain at the start of this section that what constitutes an acceptably low level of threat may vary according to the underlying subject matter of the assurance service or other engagement circumstances as defined in ISAE 3000 (Revised).

We otherwise support the proposed consequential amendments to Section 950.

12. Are there any other sections of the Code that warrant a conforming change as a result of the NAS project?

We have not identified a further need for conforming changes.