Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

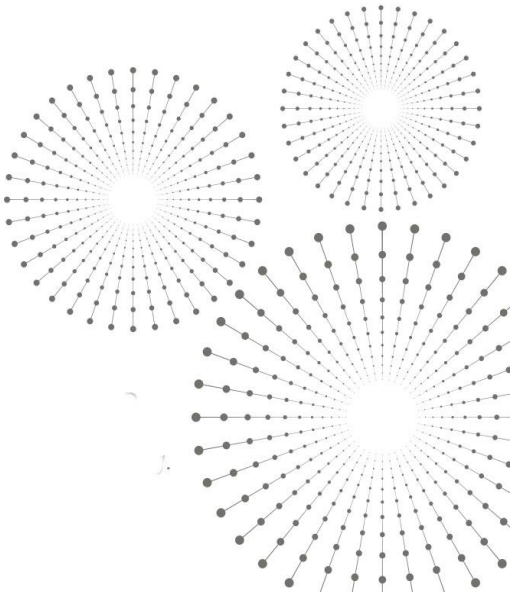
Explanation for decisions Amendments to *PES 1: Revisions to the Non-assurance Services Provisions of the Code*

June 2022

This document relates to, but does not form part of, Amendments to *Professional and Ethical Standard 1: Revisions to the Non-assurance Services Provisions of the Code*, which was approved by the NZAuASB in June 2022.

It summarises the changes made by the NZAuASB to the *International Code of Ethics for Professional Accountants (including International Independence Standards)* issued by the International Ethics Standards Board for Accountants of the International Federation of Accountants. It also summarises the major issues raised by respondents to Exposure Draft 2021/4 *Amendments* to *Professional and Ethical Standard 1: Non-Assurance Services* and how the NZAuASB has addressed them.

This document is an explanatory document and has no legal status.



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Explanation for Decisions

Amendments to *Professional and Ethical Standard 1: Revisions to the Non-assurance Services Provisions of the Code*

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1. Decision on non-assurance services

1. NZAuASB ED 2021/4 Amendments to Professional and Ethical Standard 1: Non-Assurance Services issued in July 2021 proposed to adopt the International Ethics Standards Board for Accountants' (IESBA) amendments to the Code of Ethics relating to non-assurance services.

2. ED 2021/4 proposed to strengthen the New Zealand standard as follows:

   - For an audit client that is a public interest entity, prohibit tax advisory and tax planning services, including advising on its tax return preparation or any adjustments arising therefrom.
   - Outline additional factors that are relevant in identifying self-review or advocacy threats created by providing tax advisory and tax planning services.
   - Acknowledge there may be benefits to the auditor performing certain audit-related services, that generally do not create a self-review threat to independence, and provide examples of such services. The firm would still have been required to apply the conceptual framework to identify, evaluate and address threats (both for self-review threats and other threats) to independence.
   - Limit the timeframe for the application of the transitional provision to 12 months from the effective date of the standard.

3. This document explains the rationale for the changes made by the NZAuASB in finalising *Amendments to Professional and Ethical Standard 1: Non-Assurance Services.*

2. Non-assurance services – tax planning and tax advisory services

4. In relation to tax advisory and tax planning services, the NZAuASB was particularly concerned that the IESBA's wording "confident is likely to prevail" is subjective and may be interpreted in New Zealand as setting the bar for permissible services too low. As a result, the NZAuASB proposed in its ED to prohibit tax advisory and tax planning services to an audit client that is a public interest entity, including advising an audit client in its tax return preparation or any adjustments arising therefrom.

2.1 What we heard

5. The submissions identified strongly opposing views. Those who supported the NZ ED indicated that in their view the provision of tax advisory and tax planning services is in direct conflict with the audit and presents both a self-review threat and an advocacy threat to independence that cannot adequately be managed by safeguards. Those that opposed the proposal questioned the rationale for going

beyond the international standard; stressed the importance of harmonisation with Australia; noted low levels of non-assurance services in New Zealand; and highlighted possible unintended consequences of prohibiting such services in all instances (arguing that tax planning and tax advisory services include factual representations of tax law and that not all advice creates a self-review threat).

6. Given the wide range of views received, both in response to the NZ ED and through ongoing consultation, it became apparent to the NZAuASB that there is a lack of clarity around how and why the international standard had adopted a different approach to the "self-review threat prohibition" for public interest entities, with reference to the exception where tax planning and advisory services "will not create a self-review threat" using a "confident is likely to prevail" threshold in the application material.

2.2 The IESBA position

7. Under the revised non-assurance services standard, the "might create" prohibition in relation to the self-review threat creates a robust standard, where the possibility of a self-review threat results in a prohibition for public interest entities. The IESBA intentionally revised the Code to include a definitive statement that providing tax advisory and tax planning services will not create a self-review threat in certain circumstances. The effect of the principled self-review threat prohibition would otherwise have prohibited these services.

8. The permitted circumstances are limited and specific. They relate first to where the advice is (a) supported by a tax authority or precedent or (b) based on established practice that has not been challenged by the tax authority. In these circumstances the amount of judgement being exercised by the firm is not significant and the intent was not to prohibit such services. Globally the IESBA did not receive significant concern on these two points.

9. The IESBA accepted that providing tax advice that involves very little judgement is cost effective, given that the firm knows the client and has the expertise to provide the advice. It considered there may be unintended consequences, that are not in the public interest, of prohibiting firms from advising on tax matters which are a replication of the tax law or have been effectively signed off in law or by the tax authority.

10. The third circumstance (c), that the services have a basis in law that would be "likely to prevail", did generate more debate globally. In this circumstance, there is no "signoff" by the tax authority, rather it is a judgement call by the firm.

11. The IESBA's Basis for conclusions explores this matter. Given global concerns that the term "more likely than not" would be perceived as being too low a threshold, the IESBA responded by adding the words "is confident". Minutes from the IESBA September 2021 meeting highlight that IESBA members agreed that the audit firm should have a high level of confidence in the tax advice.

12. The NZAuASB understands that in instances where the firm is confident that its advice is likely to prevail, the IESBA did not wish to impose a prohibition for the same reasons for (a) and (b). In other words, if in the professional judgement of the firm, the firm is so confident that its advice will prevail, it is not in the public interest to prohibit firms from advising on these tax matters.

2.3 Explanation for decision not to prohibit all tax planning and advisory services

13. The NZAuASB carefully considered the various views received in response to the exposure draft and evidence gathered through ongoing outreach and determined in the public interest not to proceed as exposed.

14. Through its outreach, the NZAuASB did not identify robust evidence in New Zealand that supported the prohibition as exposed. The outreach provided a consistent message that there is currently little evidence of the aggressive tax schemes in New Zealand that were more prevalent going back 20 years. Entities appear to be taking a conservative approach to their tax planning. Good practice governance, and increasing expectations around accountability, have seen those charged with governance of many entities seeking a more risk adverse position and taking more control of the entity's tax positions.

2.4 Explanation for decision to clarify the international standard

15. Based on all feedback received, on balance the NZAuASB agreed that the intent of the IESBA Code, as set out above, is appropriate for adoption in New Zealand. However, the NZAuASB considered there is a compelling reason to amend the international standard to address the need for clarity in relation to the meaning of the "confident is likely to prevail" test, together with the ability for consistent application and enforcement. It decided to do so through clearly stated responsibilities[1] in two parts: (1) clarification of the intent; and (2) the need for appropriate documentation of the judgements involved. The NZAuASB considered that approach to have the benefit of harmonisation with the global standard, adopting a principles-based, rather than a rules-based, approach.

Clarification of intent

16. The NZAuASB considers the "confident is likely to prevail" would be interpreted as being subjective. Similar concerns were raised by many stakeholders globally. Although the IESBA added the words "the firm is confident", the NZAuASB continued to hear concerns that the test is subjective and would not be clear in the New Zealand context because, for example, no firm will advise a tax treatment that it is not "confident" is likely to prevail.

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1 In line with the qualitative characteristics in assessing a standards responsiveness to the public interest. Refer to appendix 1 of the NZAuASB Policy and Process for International Conformance and Harmonisation

17. The statutory test under New Zealand law to determine whether an unacceptable tax position has been taken is set out in the Tax Administration Act 1994. The test is:

> "A taxpayer takes an unacceptable tax position if, viewed objectively, the tax position fails to meet the standard of being about as likely as not to be correct".[2]

18. The "about as likely as not" test means that there must be, at least, about an equal chance of an interpretation being likely to be correct as it is to be incorrect. The use of the word "about" makes the test less stringent, but the interpretation still needs to be close to or around 50% likely to be correct. The test is also stated as being objective (i.e., not subjective).

19. The NZAuASB interpreted the intent of the IESBA's words "is confident is likely to prevail" as setting a very high threshold, a bar significantly higher than close to or around 50%. This is different from what the New Zealand tax legislation says ("about as likely as not"). It also differs from how the term "likely" is applied in other legal contexts in New Zealand.[3]

20. Given that PES 1[4] is secondary legislation, the NZAuASB considered there is a compelling reason for the standard to be clear as to the meaning of the term "confident is likely to prevail" in this context. The NZAuASB considered there is a compelling reason to ensure that the New Zealand standard is applied so that that the high threshold intended by IESBA, which is neither the percentage-based approach of the tax legislation nor the lower test applied by the courts in other contexts, is consistently understood and applied.

21. To address the apparent subjective nature of the test, the NZAuASB agreed to add a NZ paragraph NZ 604.12 A2.1 inserting a reference to the test being objective (in similar terms to the statutory test).

Add a documentation requirement

22. Many respondents to the NZ ED noted the robust processes that firms undertake to identify and evaluate all the threats that providing a service might create to determine whether a non-assurance service is permissible.

23. The firm's level of confidence in its own tax advice is a key part of whether the self-review threat prohibition applies or not.

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2 s141B Tax Administration Act 1994.

3 For example, the courts have interpreted the term "likely to prejudice the maintenance of the law" as a withholding ground for official information under the Official Information Act 1982 (OIA) to mean that there is "a distinct or significant possibility" that the specified result may occur. If used to interpret the standard, this could result in a lower threshold being applied than IESBA intended. It is also notable that the OIA decision involved an express rejection of a percentage-based approach to applying the "likely to prejudice" test.

4 Professional and Ethical Standard 1, *International Code of Ethics for Assurance Practitioners (including International Independence Standards) (New Zealand)*

24. Given all of the feedback received, the NZAuASB agreed to add a documentation requirement, in the instances where the firm determines that providing tax planning and tax advisory services is permissible.

25. Paragraph 600.27 A1 of the revised IESBA standard sets out what documentation the firm *might* prepare, including key elements of the firm's understanding of the nature of the non-assurance service, whether and how the services might impact the financial statements, the nature of any threat created, the extent of management involvement, safeguards applied, the firm's rationale for determining that the service is not prohibited, etc.

26. In its Basis for Conclusions the IESBA stated that it envisaged that a firm may *choose* to document, in situations that are not apparent, the factors considered in determining its confidence that the proposed treatment has a basis in applicable tax law and regulation that is likely to prevail.

27. The NZAuASB considered that, having regard to the principles and practices in the public interest in New Zealand, there is a compelling reason to require documentation by the firm in the instances where it has made use of the "carve out" from the self-review threat prohibition related to tax planning and advice. This would strengthen the Code; address any concerns about documentation of evidence of decision making; and promote effective regulation. The NZAuASB doubts this requirement would be onerous, as throughout its ongoing outreach firms noted that such documentation is consistent with current best practice in New Zealand in determining whether a service is permissible or not.

28. The NZAuASB considered that requiring documentation of the factors and the rationale will also drive consistency in practice. Taken together with the recommended changes to improve clarity of application, this met the public interest factors in the compelling reason test.

3. Audit-related services

29. The NZAuASB had proposed to add application material to acknowledge that there may be benefits to the auditor performing certain audit-related services, the provision of which will generally not create a self-review threat to independence, and to provide examples of such services. The firm would still have been required to apply the conceptual framework to identify, evaluate and address threats (both for self-review threats and other threats) to independence.

30. Respondents to the NZ ED agreed that additional services performed by the audit firm will generally not create a self-review threat where the services are related to the audit engagement. However, many submitters noted that it is the nature of the service that determines whether a threat to independence arises; and that firms therefore apply the conceptual framework to identify, evaluate and address threats that might be created. Some respondents sought more clarity around the term "audit related services". Overall, respondents did not consider it necessary

to include this additional material, and one respondent highlighted the risks of unintended consequences and a risk that the NZ-specific content would not be consistent with other parts of the standard.

31. The NZAuASB agreed that there is not a compelling reason to include this additional NZ paragraph. Examples could be included by way of a FAQ or other implementation guidance, possibly in conjunction with the NZASB fee disclosure project to enhance disclosure of fees paid to audit firms in the financial statements.

4. Transitional provisions

32. The NZAuASB considered that an open-ended transitional provision which could permit a firm to continue the engagement under the extant provision for an indefinite period would be too broad for New Zealand purposes. The NZ ED therefore proposed to limit the timeframe for the application of the transitional provision to 12 months from the effective date of the standard.

33. The majority of respondents supported the proposal. However, one respondent expressed concern that modifying the effective date would introduce complexity and inconsistency for network firms.

34. On reflection, the NZAuASB decided that there is not a compelling reason to depart from the international standard, and reverted to the IESBA's transitional provisions.