

Practice Advisory

Revisions to Independence Standard (2014)

(Originally published in 2014 – updated October 2016 to incorporate changes in terminology reflected in the CPA Code of Professional Conduct (the “CPA Code”))

The Council has approved revisions to the independence standards that are contained in the CPA Code of Professional Conduct, and related Guidance. The revisions are based on the final report of the Independence Task Force (ITF) of CPA Canada’s Public Trust Committee. A number of changes have been in order that the Code be no less stringent than the requirements of the Code of Ethics for Professional Accountants (IESBA Code) issued by the International Ethics Standards Board for Accountants, unless it is determined that a particular provision is either not in the public interest or it is prohibited by law or regulation.

The changes generally take effect for assurance engagements in respect of reporting periods commencing after December 15, 2014, with transitional provisions as appropriate to ensure that the public is not prejudiced by the changes. This article summarizes some of the changes that have been made to the existing Rule and Guidance, some of the significant changes that were made to the *Exposure Draft* issued for comment in 2013. It also offers some additional guidance and resources.

Overview of revisions to existing Rule and Guidance

Changes to improve clarity and enforceability

Certain changes were made to improve the clarity and enforceability of the current Rule and Guidance. For example:

- Rule 204.2 *Compliance with Rule 204.1* has been added to clarify that, in addition to complying with Rule 204.3 *Identification of threats and safeguards*, any Member or Firm required to be independent pursuant to Rule 204.1 *Assurance and Specified Auditing Procedures Engagements* shall comply with the specific provisions of Rule 204.4 that deal with specific prohibitions for these engagements;
- Rule 204.3 *Documentation* has been moved to a new Rule 204.5 (after Rule 204.4 *Specific prohibitions*) to make it clearer that inadequate documentation of an independence matter would not, in itself, be a threat requiring safeguards or a prohibition that prevents the Member or Firm from undertaking the engagement, but it would be a violation of the Rules.
- A number of changes were made in respect of financial interest prohibitions in Rule 204.4, such as:
 - Some provisions that provide relief from the prohibitions (“relieving provisions”) were clarified, such as in the case where a financial interest held by an immediate family

member of a partner or managerial employee has been received as a result of employment (see Rule 204.4(4) and Rule 204.4(5)).

- Some sections have been eliminated, such as the references to professional employees and the 0.1% ownership test.
- The existing Rule permits a member of the engagement team (or an immediate or close family member) to hold qualifying shares in certain social clubs or organizations under specified conditions. These relieving provisions have been extended to co-operatives and credit unions or caisses populaires. [Rule 204.4(2.1)]

Extension of certain prohibitions from reporting issuers to all audit or review engagement clients

The revised standard extends certain prohibitions that currently apply in respect of providing audit services to reporting issuer clients to all audit or review engagement clients when other non-assurance services are being provided, such as the following:

- certain valuation services [Rule 204.4(25)];
- various internal audit services, unless certain conditions are met [Rule 204.4(27)(a), and (27)(b), Guidance paragraphs 1 through 6];
- information technology system services, such as financial information systems design or implementation services, where the information being generated is significant to the accounting records or financial statements, unless certain conditions are met [Rule 204.4(28)(a), and (28)(b), Guidance paragraphs 1 to 4];
- litigation support services for the purpose of advancing an audit or review client's interest in certain proceedings or investigations, if the amounts are material [Rule 204.4(29)(a) and (29)(b)]; and
- where corporate finance and similar services have been provided, and "(i) the effectiveness of the advice depends upon a particular accounting treatment or presentation in the financial statements; (ii) the outcome or consequences of the advice has or will have a material effect ...; and (iii) the engagement team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation...." [Rule 204.4(33)(b)]

Guidance has been added to cover situations where a Firm has provided non-assurance services as outlined in Rules 204.4(22) to (34) prior to commencing an engagement to provide audit or review services. [(Rule 204.4(35)(a)]

Other changes to conform to the IESBA Code

A number of changes, which impact all engagements affected by this Rule, were made to conform to the IESBA Code. These include:

- Some definitions have been revised as noted below (see the Definitions section of the Rule). The most significant are the revisions to "network Firm" and "related entity", which broaden the scope of application of the Rule:
 - "Member of a Firm" or "Member of the Firm" - Wording has been added to clarify that external experts in a field other than accounting or auditing are not subject to the independence provisions that apply to the engagement team;
 - "Network Firms" - A more prescriptive definition of a network Firm has been adopted, which refers to a "larger structure of co-operating entities that shares" significant professional resources. The previous definition referred to "common control, ownership or management". Additional guidance has been provided on the application of this definition.
 - "Related entity" - This definition has been extended from relationships where there is control, or common control, to include relationships where there is significant influence.
- One of the most significant revisions to the Rule is the addition of several prohibitions related to the provision of taxation services to audit or review clients. These include the provision of tax planning or other advisory services, where, "(i) the effectiveness of the advice depends upon a particular accounting treatment or presentation in the financial statements; (ii) the outcome or consequences of the advice has or will have a material effect ...; and (iii) the engagement team has reasonable doubt as to the appropriateness of the related accounting treatment or presentation... ". [Rule 204.4 (34)(a)]. Note that relief has been provided to allow a Firm to assist reporting issuers and listed entity clients in certain emergency situations, as outlined in the next section.
- A new Rule (Rule 204.4(40)) and related Guidance (paragraphs 1 to 3 to the subrule), were added to address independence issues arising from merger and acquisition activities of audit and review clients. The new Rule and Guidance discuss whether steps can be taken to be able to continue with the engagements, as well as which provisions need to be met.
- The prohibition in respect of performing assurance engagements, where the Member or Firm has been involved in making management decisions or performing management functions for the assurance client, has been limited to situations where the decisions or functions are "related to the subject matter of the assurance engagement". [Rule 204.4(22)(a)]
- A provision has been added to allow the temporary loan of staff to an audit or review client of the Firm, as long as certain conditions are met. [Rule 204.4(17)(b)].

Changes in respect of reporting issuer or listed entities clients

A number of changes have been to conform to the IESBA Code, as outlined below:

- A new definition, "listed entity", has been adopted, which includes those "that are not reporting issuers in Canada but are listed elsewhere". [Definitions]
- Partner rotation requirements have been modified to focus on the familiarity threat instead of an arbitrary bright-line test. The revised Rule applies to anyone who is a "key audit partner" (defined as the lead engagement partner, the engagement quality control reviewer, or other partners who make key decisions or judgments with respect to the audit) to rotate, instead of the existing Rule, which encompassed the lead engagement partner, the engagement quality control reviewer, the subsidiary entity engagement partners, and any partners providing more than 10 hours of assurance services. [Rule 204.4(20) and Definitions]
- The existing Rule precludes an audit partner on the engagement team from being compensated based on selling non-assurance services to his or her reporting issuer audit client. These requirements have been extended in a number of areas, so as to preclude "key audit partners" from being evaluated or compensated based on selling such services to a client or related entity during the period that they were a key audit partner. [Rule 204.4 (38)]
- The current Guidance considers that an independence threat may exist when a significant portion of a Firm's total fees come from an assurance client. The IESBA Code contains more specific provisions for reporting issuer or listed entity audit clients. In circumstances when total revenue from a listed entity or reporting issuer audit client represents more than 15 per cent of the Firm's total revenue for two consecutive fiscal years, the Firm shall not perform the audit unless certain provisions are met.[Rule 204.4 (37)(a)]
- Emergency provisions have been added to allow the Firm to perform the audit in certain circumstances where they have prepared tax calculations of current and future tax liabilities or assets for the purpose of preparing accounting entries that are material, or they have performed accounting and bookkeeping services for a reporting issuer or listed entity. These taxation, accounting, and bookkeeping services can only have been provided in emergency situations. Certain conditions, as well as documentation requirements, must be met in order to be able to conduct the audit in these circumstances. [Rule 204.4(34)(b) and Rule 204.4(24)(b) respectively.]
- If a former Chief Executive Officer (CEO) of the Firm takes on various roles (officer, director, or financial reporting oversight) with a reporting issuer or listed entity audit client, the Firm shall not perform an audit engagement for that entity unless one year has elapsed from the date that individual was the CEO. [Rule 204.4(16)(b)].
- Guidance has been added to address situations where a Firm has provided non-assurance services, as outlined in Rules 204.4(22) to (34), to an entity that has become a reporting issuer or listed entity. [204.4(35)(b)]

Effective Date

The revised standard is effective for assurance engagements for the first reporting period commencing after December 15, 2014, and otherwise for engagements commencing after December 15, 2014. There are transitional provisions in respect of certain engagements to provide litigation support services and in respect of the application of the definition of “key audit partner” in order to accommodate certain circumstances where the public would be prejudiced by the timing of the changes.

Revisions to proposals provided in Exposure Draft

The revisions to the CPA Code and the Guidance reflect feedback received by the ITF from stakeholders in response to the *Exposure Draft* (ED) that was issued for comment in 2013. A number of the major changes from the proposals outlined include the following:

- The ED proposed elimination of the threshold exemption to the more restrictive independence requirements applied to the audits of reporting issuers with either market capitalization or total assets in excess of \$10 million. The ITF ultimately concluded that maintaining the threshold was in the public interest. They believed that the removal of the threshold would have a significant negative impact on small reporting issuers in Canada, as well as on small firms which were unable to accommodate the partner rotation requirements, which would result in a reduction of the number of audit firms available to smaller reporting issuers.
- A couple of transitional provisions were added: one in respect of litigation support services in progress as such assignments can extend over long periods of time; and another to accommodate the revised definition of “key audit partner”, in order to allow an orderly transition so that certain partners would not be required to rotate off in the middle of an audit engagement.
- Other changes were primarily editorial.

Additional resources

Members must read the full text of the independence Rule and Guidance to gain a full and complete understanding of all the proposed changes and their implications. The CPA Code (which includes the Guidance) is in the [Member's Handbook](#), which can be found in the *Resources* area of CPA Ontario's website at www.cpaontario.ca

Additional guidance regarding the rule 204 can be found in the [Guide to Canadian Independence Standard \(updated 2016\)](#), (Click on the embedded link or visit the *Articles* section in *Practice Matters* in the *Firm* section of CPA Ontario's website at www.cpaontario.ca). Members can also



contact a Practice or Member Advisor at 416 962.1841, ext. 4456 or 1 800.387.0735, ext. 4456 or by e-mail at practiceadvisory@cpaontario.ca or memberadvisory@cpaontario.ca.