Engagement Team – Group Audit Independence
Issues and Task Force Proposals

Note to IESBA Meeting Participants

At its September 2022 meeting, the IESBA considered an analysis of the comments from respondents to the Exposure Draft, *Proposed Revisions to the Code relating to Definition of Engagement Team and Group Audits* (ET-GA ED), and an overview of the Task Force’s proposals regarding the revisions to the ED in response to those comments. The IESBA generally supported the Task Force’s views and proposals. However, the Board asked the Task Force to provide further information and, taking into account the Board’s input, develop updated proposals regarding the independence considerations for individuals involved in the group audit.

After the September 2022 IESBA meeting, the Task Force met with several key stakeholders and sought their experiences and views regarding the proposed independence principles for group audit team members, particularly in relation to individuals outside the group auditor firm’s (GAF) network who are involved in a group audit. This paper summarizes the background to, and feedback received on, that matter and explains how the Task Force is proposing to address such feedback.

For the Task Force’s responses and proposed changes to the text regarding any other areas and issues, such as the communication between the component auditor firm (CAF) and the GAF, breaches at the CAF, etc., please refer to *Agenda Item 2-A*.

I. Independence Considerations Applicable in a Group Audit

Background

1. ISA 220 (Revised) requires an engagement partner for an audit of financial statements to have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement.\(^1\) ISA 220 (Revised) also requires the engagement partner to take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm’s related policies or procedures.\(^2\) If matters come to the engagement partner’s attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner is required to evaluate the threat through complying with the firm’s policies or procedures, using relevant information from the firm, the engagement team or other sources, and take appropriate action.\(^3\) In line with the principles of ISA 220 (Revised), it is ultimately the responsibility of the group engagement partner to determine whether the CAF is in compliance with the relevant ethical requirements.\(^4\)

---

\(^1\) International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*, paragraph 16

\(^2\) Paragraph 17 of ISA 220 (Revised)

\(^3\) Paragraph 18 of ISA 220 (Revised)

\(^4\) Paragraph 21 of ISA 220 (Revised)
2. In a group audit context, ISA 600 (Revised) requires that in applying ISA 220 (Revised) a group engagement partner take responsibility for:

(a) Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and

(b) Confirming whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.5

3. The ISAs therefore establish the requirements that a firm performing a group audit engagement and all those involved in the engagement, including individuals and CAFs within or outside the GAF’s network, comply with relevant ethical requirements, including those related to independence, that apply to the group audit engagement. ISA 220 (Revised) explains that relevant ethical requirements ordinarily comprise the provisions of the IESBA Code related to audits of financial statements, together with national requirements that are more restrictive.6

4. One of the objectives of the Engagement Team – Group Audits Independence Project is to specify the provisions that comprise the relevant ethical requirements, including those related to independence, referred to in ISA 220 (Revised) and ISA 600 (Revised). The provisions being developed in this project will address the independence considerations applicable to both the individuals and the firms involved in the group audit.

II. Independence Considerations Applicable to Audit Team Members

A. Proposals in the ET-GA Exposure Draft and Key Comments

Independence Principles Applicable to Individuals Involved in the Group Audit

5. The extant Code already addresses the personal independence requirements with respect to an audit client. For a CAF that belongs to the GAF’s network, individuals from that CAF who participate in the audit of the component are effectively also required to comply with the same personal independence requirements that apply to the engagement team at the GAF.7

6. The change in the definition of an engagement team in ISA 220 (Revised) resulted in a need to clarify the independence requirements for individuals involved in a group audit from outside the GAF’s network. In the ET-GA ED, the IESBA proposed that the same independence provisions that apply to individuals from the GAF and CAFs within the GAF’s network should apply to individuals carrying out audit work from CAFs outside the GAF’s network. (Appendix 1 illustrates the ED’s approach in the case of listed and non-listed group audit clients.)

7. The IESBA took the view that the work of the individuals from the CAFs outside the GAF’s network contributes to the audit opinion on the group financial statements just as much as the work performed by individuals from the GAF and CAFs within the GAF’s network. This view aligned with the thrust of the revised engagement team definition in ISA 220 (Revised), which treats all individuals performing

---

5 ISA 600 (Revised), Special Considerations – Audits of Group Financial statements (Including the Work of Component Auditors), paragraph 25
6 ISQM 1, paragraph 16(t), and ISA 220 (Revised), paragraph 12(k)
7 Paragraph R400.51 of the extant Code states the following: “A network firm shall be independent of the audit clients of the other firms within the network as required by this Part.”
audit procedures on the engagement, whether from within or outside the GAF’s network, as engagement team members.

Independence Principles Applicable to Firms Involved in the Group Audit

8. As a starting point, the IESBA noted that no new principles are required for the GAF or CAFs within the GAF’s network as the extant Code already requires a firm and its network firms to be independent of the audit client. (See paragraphs R405.9 and R405.10 in Agenda Item 2-A)

9. Concerning independence in relation to CAFs outside the GAF’s network, the IESBA agreed to a proportionate approach. The Board was of the view that in the case of CAFs outside the GAF’s network, the greatest threats lie with respect to the component audit client (as defined in the ED) and the entity on whose group financial statements the GAF expresses an opinion. Therefore, the IESBA proposed to require a CAF outside the GAF’s network to be independent of the component audit client, and to prohibit certain financial interests, loans and guarantees with respect to the entity on whose group financial statements the GAF expresses an opinion. The IESBA’s view was that imposing the same independence requirements on CAFs outside the GAF’s network as for the GAF and its network firms would be disproportionate and potentially unduly limit the supply of firms able to act as CAFs. The Board explained in the explanatory memorandum to the ED that the application of the conceptual framework and the “reason to believe” principle provided the appropriate approach to dealing with the threats to independence with respect to the other entities in the group.

Key Comments from Respondents to the Exposure Draft

10. The ED explicitly asked for stakeholders’ views about the principles the IESBA was proposing for:

(a) Independence in relation to individuals involved in a group audit; and
(b) Independence in relation to firms engaged in a group audit, including CAFs within and outside the GAF’s network.

11. Respondents generally supported the ED’s approach regarding the independence considerations applicable to the GAF, its network firms, and individuals in the group audit team who are from, or engaged by, the GAF or a network firm. However, regarding the proposed independence considerations applicable to CAFs and individuals from CAFs outside the GAF’s network, some respondents raised concerns about the proportionality of the approach and its overall impact on the market and audit quality.

12. A few respondents commented that when a small or medium practice (SMP) acts as a CAF for group audit clients that are PIEs, it might be challenging to ensure the firm’s independence in accordance with the PIE provisions, especially in jurisdictions where there are few auditors in a particular industry or with a specific specialty. There were some concerns that the proposals would negatively impact SMPs as the component audits may be pushed towards the larger network firms. Some commenters pointed out that this could lead to market concentration and could eventually impact audit quality. A few respondents raised for the IESBA’s consideration whether the additional cost and work effort in managing independence at a component level would outweigh any uplift in audit quality for smaller entities and smaller component auditors.

13. It was also pointed out that while a CAF outside the GAF’s network has to be independent mainly with respect to the component audit client, the CAF still has to monitor the independence of its group audit team members. It was felt that this would be an inconsistent approach and overly burdensome.
Although these respondents did not question the principle, they raised potential practical challenges. They asked the IESBA to consider a more balanced approach focusing only on relationships with entities more likely to threaten the individual’s independence.

14. In this regard, some respondents questioned whether it is necessary that individuals from CAFs outside the GAF’s network who are involved in the group audit apply the same independence requirements applicable to the audit team in Part 4A of the Code in relation to all the related entities of the group audit client, especially parent and sister entities for a listed group audit client.

Task Force’s Proposals for the September 2022 IESBA Meeting

15. Regarding the relevant independence provisions applicable throughout the group, the Task Force referred to the Board’s previous discussions. Given that the focus of the group audit is reporting on the group financial statements, the IESBA had previously agreed, as a general principle, that the independence provisions that apply at the group level should apply throughout the group, including to CAFs outside the GAF’s network.

16. Although the Task Force proposed some clarification regarding the relevant ethical requirements applicable when the group audit client is a PIE, the Task Force noted that it would not be appropriate for the Code to establish less stringent requirements for CAFs outside the GAF’s network based on the size and the significance of the component. This is because ISA 600 (Revised) does not make such a distinction. At its September meeting, the IESBA did not believe it would be necessary to change this general principle.

17. The Task Force also considered and acknowledged the potential practical challenges CAFs outside the GAF’s network might face in monitoring the independence of their group audit team members with respect to all entities within a group audit client, especially in the case of listed group audit clients. Upon due reflection, the Task Force was of the view that the cost of implementing a system that could support compliance with such independence requirements at a CAF outside the GAF’s network could be disproportionate relative to the likelihood of threats created. Besides the cost factor, the Task Force recognized that if the CAF had to monitor the independence of individuals with respect to all entities within the group audit client, this could become a significant compliance task that would take resources and time away from the CAF’s focus on the audit work, potentially adversely impacting audit quality. The Task Force therefore considered and agreed that applying the same independence requirements to all audit team members, within and outside the GAF’s network, would not be in the public interest.

18. Consequently, irrespective of whether the group audit client is a listed entity, the Task Force proposed that the Code does not require a group audit team member within, or engaged by, a CAF outside the GAF’s network to apply the same independence requirements in Part 4A that apply to the audit team in relation to the following related entities or components within the group:

- Any entity that has direct or indirect control over the group audit client.
- Any sister entities of the group audit client (as defined in the “related entity” definition in the Glossary of the Code).
- Any entities in which the group audit client, or its controlled entity, has a direct financial interest that gives it significant influence over such entities and the interest is material to the group audit client and its controlled entity.
ET-GA – Issues and Task Force Proposals
IESBA Meeting (November-December 2022)

- Any components in the group that are not related entities.

19. In aiming for a proportionate approach, the Task Force further proposed the following 3 options in relation to the rest of the corporate tree for the Board’s consideration (see Appendix 2):

- **Option 1:** Require group audit team members from a CAF outside the GAF’s network to be independent in accordance with the provisions of Part 4A in relation to the component audit client (as defined) and the entity on whose group financial statements the group auditor firm expresses an opinion. The Task Force was of the view that those are the entities where the greatest threats to independence lie.

  The Task Force pointed out that this approach aligns with the independence principle proposed for CAFs outside the GAF’s network. The Task Force considered that this approach would exclude a large number of entities controlled by the group audit client with limited or no relevance to the audit of the component audit client and would fully address the administrative burden and other practical challenges some of the respondents have raised. However, the Task Force acknowledged that this option would constitute a significant shift from the proposal in the ED and could raise questions regarding independence in appearance for those group audit team members.

- **Option 2:** Based on this approach, the group audit team members from a CAF outside the GAF’s network would be required to be independent in accordance with provisions of Part 4A in relation to the entities that are (a) controlled by the group audit client, and (b) belong to the chain of control of the component audit client.

  The Task Force believed that this option would also exclude a potentially large number of entities controlled by the group audit client that are not part of the chain of control of the component audit client and could go some way towards addressing the practical challenges that have been raised. Nevertheless, the Task Force acknowledged that scoping only entities within the chain of control would not be in line with the definition of related entities in the Code and could add further complexity to the independence principles. Nevertheless, the Task Force felt that this option would provide a more balanced approach vis-à-vis the potentially large number of entities that could be involved and the practical challenges in relation to monitoring independence at the CAF level.

- **Option 3:** This approach provided that the group audit team members from a CAF outside the GAF’s network would be required to be independent in accordance with provisions of Part 4A in relation to all controlled entities of the group audit client.

  Although this approach is in line with the Code’s “related entity” concept, the Task Force noted that this option would still scope in a potentially large number of controlled entities that are not part of the chain of control of the component audit client and only have limited or no relevance to the component audit.

20. The Task Force emphasized that even if the Code did not require the group audit team members from CAFs outside the GAF’s network to comply with the provisions of Part 4A in relation to all entities within a group, this would not mean that a CAF outside the GAF’s network should not consider and address any threats created by any relationship or circumstance involving its group audit team members. The Task Force noted that the proposals would still require the CAF outside the GAF’s
network to apply the “reason to believe” principle and include such a relationship or circumstance when identifying, evaluating, and addressing threats to the CAF’s independence.

Feedback from IESBA and IESBA Consultative Advisory Group (CAG) Meetings in September 2022

21. IESBA members acknowledged the potential practical challenges respondents raised concerning monitoring the personal independence of group audit team members from CAFs outside the GAF’s network. After lengthy deliberations, most IESBA members agreed with the Task Force’s view that Option 2 could provide a reasonably well-balanced approach, recognizing both the practical concerns raised and the need to maintain an overall robust approach to independence at the CAF level. A few of the members who supported Option 2 clarified that Option 1 was also an approach they could support.

22. A few IESBA members expressed concerns that the proposed options would result in a significant shift from the ED’s approach, which was supported by regulatory respondents. They suggested that the Task Force consult with the IAASB to understand if the proposed approach would align with the general principles in ISA 220 (Revised) and ISA 600 (Revised).

23. CAG representatives had mixed views on the proposed revisions regarding the independence considerations for individuals. Representatives of the profession supported the revisions and appreciated the Task Force’s considerations of the practical concerns, especially for SMPs.

24. Meanwhile, regulatory and investor CAG representatives expressed concerns about applying different independence provisions for certain group audit team members, especially in the case of listed group audit clients. They felt that the proposed revisions might be perceived as the IESBA proposing a “lower level” of independence in the case group audit team members outside the GAF’s network on the ground of cost.

B. Feedback from Key Stakeholders in Q4 2022

Feedback from IAASB Representatives

25. The Task Force held two virtual meetings in October 2022 with representatives of the ISA 600 Task Force and IAASB Staff and presented them with the Task Force’s revised approach in response to the feedback from stakeholders.

26. The IAASB representatives noted that in the context of the foundational principles, ISA 220 (Revised) treats all individuals performing audit procedures on the engagement, whether from within or outside the GAF’s network, as engagement team members. When applied in ISA 600 (Revised), the relevant ethical requirements applicable to the group audit apply to individuals from the GAF, individuals from CAFs within the network, and individuals from CAFs outside the GAF’s network if they carry out audit work at the component level.

27. However, the IAASB representatives acknowledged that the IESBA defines the ethical requirements under the Code. As the ISAs require compliance with relevant ethical requirements, they agreed that having different provisions for individuals within the Code does not technically breach compliance with ISA requirements. The IAASB representatives emphasized the importance of making sure that differential provisions applicable to group audit team members from firms outside the GAF’s network would not affect the desired outcome, i.e., independence in fact and in appearance of the group audit firm for purposes of the group audit engagement.
28. The IAASB representatives also noted the importance of communications between the group auditor and component auditors from firms outside the GAF’s network so that the differential provisions are fully understood, and that all parties have the information needed to assess compliance with the relevant ethical requirements for purposes of the group audit. They noted that having differential provisions for individuals from firms outside the GAF’s network does not change the responsibility of the GAF and the group engagement partner to (a) understand the group structure and appropriately communicate information to the engagement team for the group audit, and (b) evaluate threats to compliance with relevant ethical requirements and take appropriate action. Similarly, such differential provisions do not change the obligation of a CAF from outside the GAF’s network that is doing work for a group audit to make sure that there is nothing that would threaten the independence of the GAF.

29. The IAASB representatives suggested that it might be helpful for stakeholders to understand how the independence principles applicable to group audits, including the conceptual framework, the requirements in Section 405 and the “reason to believe” principle serve to safeguard independence for purposes of the group audit.

Feedback from Key Stakeholders

30. The Task Force and IESBA Staff presented the Task Force’s proposals and the outcomes of the IESBA’s September 2022 discussion to the PIOB and the following stakeholders and asked for their feedback, including their experiences as appropriate, regarding the involvement of CAFs outside the GAF’s network in a group audit:

- International Forum of Independent Audit Regulators (IFIAR), Standards and Coordination Working Group (SCWG)
- International Organization of Securities Commissions (IOSCO), Committee 1 (C1)
- IFAC SMP Advisory Group
- Forum of Firms

31. The PIOB appreciated some of the concerns raised on the ED concerning practical challenges for CAFs outside the GAF’s network, and the IESBA’s efforts to respond to those concerns through the proposed proportionate approach under Option 2 as described above. A question was, however, raised at the PIOB regarding the argument that CAFs might face challenges in accessing information. It was noted that the GAF would need to know about the entire corporate tree for the group audit and therefore could readily communicate that information to the CAFs.

32. The PIOB also suggested that any exceptions to the independence requirements for CAFs outside the GAF’s network should be limited and be based on evidence about the practical challenges. The PIOB emphasized that independence, both in appearance and in fact, is foundational to an audit and in the public interest. The PIOB was of the view that the IESBA needs to carefully balance the application of the independence principles against the need to address practical challenges and unintended consequences that could impair the effective application of the Code.

33. Representatives of the IFIAR SCWG and IOSCO C1 also wondered whether there was any evidence regarding the practical challenges related to the proposed independence principle in the ED concerning individuals from CAFs outside the GAF’s network. They asked if the Board had considered any information regarding the involvement of CAFs outside the GAF’s network in the group audit of PIEs or any other entities that could support the concerns about potential increased
market concentration. The IFIAR and IOSCO representatives noted that group audits of listed entities in some of their jurisdictions (e.g., US, UK and the Netherlands) are mainly carried out by firms from the same network.

34. A representative of the IFIAR SCWG acknowledged that the structure of large groups could be really complex with hundreds of components. Therefore, the representative was of the view that there is a valid concern about potential increased market concentration as an unintended consequence of the ED proposal. Another SCWG representative asked whether ensuring a level playing field for CAFs outside the GAF’s network is necessary. The representative wondered whether the public interest would be better served if only network firms participate in group audits.

35. A few IFIAR SCWG and IOSCO C1 representatives suggested that the IESBA provide more clarity regarding the application of the “reason to believe” principle to ensure consistent application.

C. Task Force’s Proposal for IESBA’s Consideration in December 2022

Group Audits Involving Individuals Outside the GAF’s Network

36. At its meetings in Q4, the Task Force considered the suggestions from the PIOB and some of the key stakeholders that the IESBA seek evidence concerning the practical concerns to support a change from the proposal in the ED.

37. Regarding evidence about actual practical challenges, the Task Force first considered the circumstances when a GAF would ordinarily decide to involve firms outside its network in the group audit. As it is difficult to find data on group audits at a global level, the Task Force considered the regulations and practices relevant to group audits and the size of entities to which those regulations and practices usually apply. Although there is a wide range of types and sizes of group audits, the Task Force believes that GAFs usually only involve CAFs outside their networks in the group audit when the group audit client is a larger multinational conglomerate with components worldwide.

38. At several of the Task Force’s outreach activities, stakeholders shared the Task Force’s views in this regard and agreed that the IESBA’s proposed independence principles for CAFs and group audit team members in CAFs outside the CAG’s network should be operable typically in the context of complex, transnational group audits. Appendix 3 provides two examples of large groups with many subsidiaries and business lines to demonstrate the complexities of these structures.

39. During the Task Force’s outreach activities in Q4 2022, a few stakeholders questioned whether the differential approach proposed for group audit team members outside the GAF’s network addresses only rare or exceptional cases. They suggested that the Code set the same independence provisions for all group audit team members and that the IESBA consider whether any exceptions would be necessary for specific situations when particular practical challenges arise. Based on Task Force members’ experiences and the information received from key stakeholders, the Task Force believes that the challenges would be present in most of the large multinational, multi-industry conglomerate companies’ group audits that involve CAFs outside the GAF’s network. The Task Force does not believe that these challenges would be specific to a few exceptional cases.

Practical Challenges for Component Auditors Firms outside the Group Auditor Firm’s Network

40. A few respondents to the ED and other stakeholders expressed concerns that a CAF outside the GAF’s network may not have sufficient information about all the entities in the group, especially entities that are outside the chain of control of the component audit client. Therefore, they argued
that CAFs outside the GAF’s network might not be able to monitor the independence of individuals with respect to all entities in the group.

41. Responding to these concerns, the Task Force proposed at the September 2022 IESBA meeting that the Board consider introducing new provisions in Section 405 to enhance communication between the GAF and CAFs. Leveraging the communication requirement in ISA 600 (Revised),8 the Task Force proposes that the Code require the GAF to communicate to CAFs at appropriate times the necessary information to enable them to meet their responsibilities under Section 405. This communication includes, for example, the related entities and other components within the group audit client that are relevant to the independence considerations applicable to CAFs and group audit team members within, or engaged by, the CAFs. (See paragraphs R405.3 and 405.3 A1 of Agenda Item 2-A.)

42. The information communicated by the GAF to the CAF about the group audit client and its related entities and other components will depend on the group engagement partner’s judgment regarding the necessity of the information for the CAF’s compliance with the independence requirements applicable to the group audit. In the case of a group audit client with few related entities and other components, the GAF could communicate information about all the relevant entities and other components. In such a case, there are fewer practical challenges with monitoring independence with respect to the entire group. However, as explained in the subsection above, the involvement of CAFs outside the GAF’s network often occurs in large multinational, multi-industry conglomerates, potentially with multiple PIEs found within the related entities. The GAF may determine that providing information about all related entities and components in each jurisdiction in relation to each business in which the group operates could inundate the CAF and would be unnecessary. Further, given that a component in a group might be a business unit, function or business activity, the entities that are relevant to the group audit client might not fall within the related entity definition. It is therefore ideal that the GAF determines and communicates what is most relevant to the CAF’s compliance with Section 405.

43. The Task Force further notes that this regular communication would not necessarily eliminate the CAFs’ burden of processing and analyzing such raw data, especially if mergers, acquisitions or disposals occur regularly within the group. Depending on the extent of the information received from the GAF, processing and analyzing the information at every update of the group structure could create a significant administrative burden on the CAF.

44. The Task Force considered on due reflection that there are potentially two ways an individual can determine their independence in the group audit context:

(a) Based on the list of all the related entities and components of the group audit client the individuals were provided with, they could assess in relation to each related entity or component whether there are any relationships or circumstances that would impact their independence when performing audit procedures at the component audit client; or

(b) The individuals could assess whether they have any relationship or other circumstance addressed by the International Independence Standards, and whether that relationship or circumstance is tied to the group audit client.

---

8 Paragraph 25 and bullet (c) of paragraph 45 in ISA 600 (Revised)
The proper application of the Code and the conceptual framework would lead to the same outcome regarding independence with respect to the component audit client.

45. The Task Force believes that in the case of Option (a) above, the monitoring burden, depending on the volume of data provided, could be disproportionate relative to the likelihood of threats to independence in related entities of the group audit client outside the chain of control of the component audit client. Importantly, there is a significant risk that this would become a compliance exercise that would draw time and attention of the group audit team members from the CAFs outside the GAF’s network away from their focus on addressing the significant risks in the component audit, which would be detrimental to audit quality.

46. The Task Force also notes that these practical challenges are an issue not only for SMPs participating in the group audit but also for mid-tier firms acting as CAFs outside the GAF’s network in a group audit. Consequently, the Task Force believes that the main question is not whether the approach in the ED could exacerbate market concentration but whether it would impose a burden on the CAFs outside the GAF’s network that would be so disproportionate when extended across all entities within the group that it would not be in the public interest.

47. Given these considerations, the Task Force believes there is reason to develop an alternative approach based on Option (b) above for group audit team members from CAFs outside the GAF’s network that would be equally robust and effective in identifying, evaluating and addressing threats to independence, and that would better serve the public interest. In this regard, the Task Force agrees with stakeholders’ views that different provisions applicable to group audit team members within or outside the GAF’s network should not result in different independence outcomes. The Task Force is not proposing that the Code set a lower standard of independence for certain group audit team members. The Task Force believes that applying different approaches to group audit team members within and outside the GAF’s network, taking into account their different circumstances, could provide a more thoughtful and better targeted approach for each group audit team member that would lead to the same outcome regarding independence.

Proposed Better Targeted Approach

48. At the September 2022 Board meeting, in efforts to be responsive to comments to the ED, the Task Force proposed that the Code require group audit team members from CAFs outside the GAF’s network to be independent of certain entities within the group in accordance with the provisions of Part 4A that apply to audit team members. To determine the list of such entities, the Task Force proposed that the Board consider entities and components within the group where the greatest threats lie with respect to the independence of the group audit team members. Furthermore, the Task Force emphasized the importance of the CAF and its network having sufficient and timely access to information about these entities. The Board supported that such entities include those that are in the chain of control of the component audit client, i.e., (i) the component audit client and its controlled entities, (ii) the entity on whose group financial statements the GAF expresses an opinion, and (iii) any intermediate holding entity between the component audit client and the entity in (ii) (see Option 2 in Appendix 2). Regarding any relationships or circumstances with respect to any other entities and components within the group, the Task Force proposed that the CAF apply the “reason to believe” principle.

49. The Task Force considered the feedback from some stakeholders that the approach of requiring the CAF to apply the “reason to believe” principle might not be robust and could lead to inconsistent
application. On further reflection, the Task Force agreed it would be appropriate to clarify this approach and provide more specific guidance for CAFs and their group audit team members to more effectively identify threats to independence with respect to entities outside the chain of control of the component audit client.

50. Therefore, with respect to these entities and components within the group audit client, the Task Force proposes that the Code require a member of the group audit team within, or engaged by, a CAF outside of the GAF’s network to notify the CAF of any relationship or circumstance the individual knows, or has reason to believe, might create a threat to the individual’s independence in the context of the group audit (see paragraph R405.7 in Agenda Item 2-A).

51. The Task Force notes that the “reason to believe” principle rests on the application of the conceptual framework and is a well-established principle in the Code that already applies to individuals in other contexts. The Code also requires professional accountants to have an inquiring mind and exercise professional judgment. In the context of the group audit and applying the “reason to believe” principle, an understanding of the facts and circumstances, including any interests and relationships that might compromise independence, is a prerequisite to a group audit team member’s identification of threats to independence. This ensures that the proposed guidance for group audit team members outside the GAF’s network provides an appropriate and robust way to identify any threats to the group audit team member’s independence.

52. In support of placing the requirement to apply the “reason to believe” principle on the individual group audit team members within, or engaged by, the CAFs outside the GAF’s network, the Task Force proposes that the Code provide guidance regarding the types of relationships and circumstances involving an individual or any of the individual’s immediate family members, as applicable, that the individual might consider when complying with this requirement. The list of relationships and circumstances set out in the guidance conforms to all the relevant independence requirements in Part 4A of the Code applicable to audit team members (see paragraph 405.7 A1 in Agenda Item 2-A).

53. The Task Force believes that this approach better achieves the desired outcome by focusing the attention of the group audit team members on the actual relationships or circumstances that could create a threat to their independence. This more targeted approach contrasts with the ED approach of imposing a compliance task involving each group audit team member going through a potentially

---

9 The determination of the related entities is based on the Code’s related entity definition in the Glossary. This definition is the same irrespective of whether the group audit client is a listed entity.

10 For example:
- When the professional accountant knows or has reason to believe that the information with which the accountant is associated is misleading, the accountant is required to take appropriate actions to seek to resolve the matter (paragraphs R220.8 and R209).
- A professional accountant must not place pressure on others that the accountant knows, or has reason to believe, would result in the other individuals breaching the fundamental principles (paragraph R270.3).
- As defined, an audit client that is a listed entity includes all of its related entities. For all other entities, references to an audit client in Part A include related entities over which the client has direct or indirect control. When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm’s independence from the client, the audit team is required include that related entity when identifying, evaluating and addressing threats to independence (paragraph R400.20).

11 Paragraph R120.5
long list of entities within the group, in many cases with frequent updates to such a list, that would effectively turn into a “tick-the-box” exercise.

54. Under this revised approach, if, for example, a group audit team member’s immediate family member is a full-time teacher and is not employed in any roles where they influence financial statements, Section 521 of the Code would not be applicable to the assessment of the group audit team member’s independence with respect to the group audit no matter which entities are in the corporate tree. However, if the immediate family member is in a financial reporting oversight role, the group audit team member is expected to consider whether that employment relationship is with any entity in the group. Likewise, in applying the “reason to believe” principle, the group audit team member would consider each of the other types of relationships or circumstances set out in the proposed guidance in paragraph 405.7 A1.

55. The Task Force highlights that proposed paragraphs R405.7 and 405.7 A1 would also be applicable to independent service providers who are engaged by a CAF outside the GAF’s network and who perform audit procedures for the group audit. If an independent service provider identifies any threats to independence, the service provider is required to notify the CAF which engaged them about such threats in accordance with the proposed provisions.13

56. Appendix 4 includes an illustration of the updated proposals for group audit team members within, or engaged by, CAFs outside the GAF’s network. The list of related entities in the diagram is not exhaustive. It only serves to demonstrate the potential scope of related entities of the group audit client and other components.

57. If a group audit team member within, or engaged by, a CAF outside the GAF’s network identifies any relationship or circumstance that creates a threat to the individual’s independence, the Task Force proposes that the individual notify the CAF accordingly (see paragraphs R405.7 in Agenda Item 2-A). The Task Force proposes that upon receiving the notification, the CAF evaluate and address any threats to independence created by the individual’s relationship or circumstance (see paragraph R405.8). If the CAF outside the GAF’s network cannot reduce the threats to an acceptable level, the individual cannot serve as a member of the group audit team at the CAF.

58. Based on the proposed requirement in paragraph R405.4, a CAF outside the GAF’s network is required to communicate to the group engagement partner (i) any independence matters that require significant judgment, and (ii) the CAF’s conclusion regarding whether the threats to its independence are at an acceptable level, and the rationale for that conclusion. This requirement would also be applicable to any independence matters regarding group audit team members from a CAF outside the GAF’s network arising from the application of paragraph R405.7. Ultimately, in line with paragraph 21 of ISA 220 (Revised),14 it is the responsibility of the group engagement partner to determine whether independence requirements have been fulfilled for purposes of the group audit.

59. The Task Force believes that this revised and better targeted approach concerning independence for group audit team members from CAFs outside the GAF’s network will result in the same outcome as the approach proposed in the ED, but do so in a more operable and proportionate manner, with a

---

12 Section 521, Family and Personal Relationships

13 Similarly, if the independent service providers are engaged by the GAF or any of its network firms and they carry out audit procedures for the group audit, they would need to comply with the provision in paragraph R405.5.

14 Paragraphs 18 and 21 of ISA 220 (Revised)
lower likelihood of unintended consequences for audit quality, and thus better serving the public interest.

Matter for the IESBA’s Considerations

1. Do IESBA members agree with the Task Force’s revised proposal regarding independence for group audit team members in CAFs outside the GAF’s network as set out above?

III. Effective Date

60. Given that the main objective of the proposed changes to the Code relating to group audits is to articulate the specific independence provisions that form part of the concept of “relevant ethical requirements, including those related to independence” referred to in ISA 600 (Revised), the IESBA proposed in the ED that the effective date of the proposed changes arising from this project should be aligned with the effective date of ISA 600 (Revised). Respondents to the ED generally supported that proposal.

61. Consequently, the Task Force is proposing that the changes and Section 405 become effective for audits and reviews of financial statements and audits of group financial statements for periods beginning on or after December 15, 2023.

62. Some representatives of the Forum of Firms, however, have raised concerns regarding the proposed effective date, highlighting that it does not provide sufficient time for adoption and implementation. They noted a risk that this could lead to inconsistent application.

63. Although the Task Force recognizes the challenges related to the short period available for adoption and implementation, it notes that it is in the public interest for the relevant provisions to become effective at the same time as ISA 600 (Revised), especially given that the revised definition of engagement team is integral to ISA 600 (Revised). The Task Force notes that subject to Board approval of the final provisions at the November-December 2022 IESBA meeting, Staff can make the unofficial final text of the provisions available on the IESBA website by the end of the year, pending PIOB consideration and approval of the final text in early April 2023. This would enable national standard setters and firms to make an early start on adoption and implementation activities pending release of the final pronouncement in April 2023.

64. Based on the proposed Section 405, if the group audit client is a PIE, a CAF outside the GAF’s network is required to comply with the provisions in Section 600 applicable to PIE audit clients with respect to the component audit client (subject to the exception provided in paragraph R405.17). This requirement applies irrespective whether the component audit client is a PIE. In line with the NAS final pronouncement issued in April 2022, the Task Force proposes a transitional provision for NAS to the component audit client that a CAF has started before the effective date of the requirements in Section 405 (see the transitional provision in Agenda Item 2-A).

Matter for IESBA Consideration

2. Do IESBA members agree with the proposed effective date as set out in Agenda Item 2-A?
IV. Due Process Matters

Significant Matters Raised by Respondents

65. The Task Force has carefully considered all significant matters raised by the respondents to the ED, including Monitoring Group members. The Task Force’s analysis of the significant matters raised by respondents to the ED and its proposals have also been presented in the September 2022 public agenda papers for the Board’s deliberation. In the Task Force’s view, there are no significant matters raised by the respondents that have not been brought to the Board’s attention.

Need for Further Consultation

66. The Task Force believes that all significant matters have been duly deliberated by the Board. The Task Force has also pursued extensive outreach to stakeholders throughout the life cycle of this project, including meetings with the IESBA Consultative Advisory Group (CAG), members of the regulatory community (including the IFIAR and the ISOCO), the Forum of Firms, the IFAC SMP Advisory Group. Finally, this project has benefited from close coordination with the IAASB.

67. On the basis of the above, the Task Force does not believe there is a need for further consultation with stakeholders.

Consideration of the Need for Re-Exposure

68. The main revisions to the ED (See Agenda Item 2-C):
   - Clarify and align the definitions of the group audit client and component audit client to the extant Code’s audit client definition.
   - Clarify the guidance regarding which types of experts are included in the definitions of engagement team and audit team.
   - Include new requirements on communication between the GAF and CAFs to complement requirements in ISA 600 (Revised).
   - Set out guidance for the determination of the period during which the independence of a CAF outside the GAF’s network is required.
   - Provide a more thoughtful and proportionate approach for independence considerations applicable to group audit team members within, or engaged by, a CAF outside the GAF’s network.
   - Provide enhanced guidance regarding the provisions prohibiting a CAF outside the GAF’s network from holding financial interests in, and having loans involving, the group audit client.
   - Clarify requirements for CAFs where the component audit client is not a PIE but the group audit client is a PIE.
   - Provide guidance where there is a change at a CAF or a component.
   - Enhance the consistency of the process for addressing a breach at CAFs within and outside the GAF’s network.
   - Enhance and clarify the approach to, and content of, the GAF’s communication to TCWG of the group about any breaches at the CAF level.
69. The Task Force considers the changes reflected in the final proposed text post-exposure respond to the feedback received from respondents to the ED and do not fundamentally or substantively change the proposals in the ED. Accordingly, the Task Force is of the view that re-exposure is not warranted.

Matter for IESBA Consideration

3. Do IESBA members agree that the changes to the ED do not warrant re-exposure?
Independence Considerations Applicable to All Audit Team Members as Proposed in the Exposure Draft

When Group Audit Client is a listed PIE

- Parent “H”
  - Sister “B”
  - Group Audit Client “A”
    - Significant Interest “E”
    - Controlled “D1, D2, …”
  - Controlled “C”

- Other Components
  - Component Audit Client “F”
  - Controlled “G”

- The component auditor firm is required to consider when applying the “reason to believe” principle

When Group Audit Client is not a listed PIE

- Parent “H”
  - Sister “B”
  - Group Audit Client “A”
    - Significant Interest “E”
    - Controlled “D1, D2, …”
  - Controlled “C”

- Other Components
  - Component Audit Client “F”
  - Controlled “G”

In addition to the component audit client, independence is required in accordance with provisions in Part 4A applicable to audit team members.
Appendix 2

Independence Considerations Applicable to Audit Team Members outside the Group Auditor Firm’s Network

Options IESBA Considered at its September 2022 Meeting

All Group Audit Clients

Option 3
Entities where greatest threat to independence lies

Parent “H”

Sister “B”

Group Audit Client “A”

Significant Interest “E”

Controlled “D1, D2, …”

Controlled “C”

(…….)

Other Components

Component Audit Client “F”

Controlled “G”

Independence is required in accordance with provisions in Part 4A applicable to audit team members

Option 2
Entities that directly or indirectly control or are controlled by component audit client

Parent “H”

Sister “B”

Group Audit Client “A”

Significant Interest “E”

Controlled “D1, D2, …”

Controlled “C”

Component Audit Client “F”

Controlled “G”

The component auditor firm is required to consider when applying the “reason to believe” principle

Option 1
Entities directly or indirectly controlled by group audit client

Parent “H”

Sister “B”

Group Audit Client “A”

Significant Interest “E”

Controlled “D1, D2, …”

Controlled “C”

Component Audit Client “F”

Controlled “G”

Other Components

Component Audit Client “F”

Controlled “G”
Appendix 3

(Note: This Appendix illustrates the breadth of entities in two large multi-national, multi-industry conglomerates. It does not indicate whether the GAFs for the group audits are using the work of CAFs outside the GAFs’ networks.)

Samsung Electronics Co., Ltd., had 228 consolidated subsidiaries in 65 countries as of December 31, 2021.

General Electric Company had 258 subsidiaries in 45 states/countries as of December 31, 2021.

Source: Samsung Electronics Co., Ltd., and its subsidiaries
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
https://images.samsung.com/is/content/samsung/assets/global/ir/docs/2021_con_quarter04_note.

Source: General Electric Company, Form 10-k Exhibit 21: Subsidiaries of Registrant,
Appendix 4

Independence Considerations Applicable to Audit Team Members outside the Group Auditor Firm’s Network

Task Force’s proposals for the IESBA’s consideration at its December 2022 Meeting

For All Group Audit Clients

The diagram is for illustrative purposes only. It does not seek to cover the full scope of all the potential related entities of the group audit client that might exist.

Independence in accordance with proposed paragraph R405.6 in Agenda Item 2-A

Independence in accordance with proposed paragraphs R405.7 to R405.8 in Agenda Item 2-A