IESBA Meeting (September 2022)

Agenda Item 5-D.4

Compilation of Comments to ET/GA ED – Question 4

Note to IESBA Meeting Participants

This reference document includes the compilation of the comments from the 49 comment letters submitted in response to the following Question 4 of Exposure Draft, Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits (ED):

“Independence in a Group Audit Context

In relation to the proposals in Section 405 (Chapter 1), do you agree with the principles the IESBA is 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 CA firms within and outside the GA firm’s network?”

For the analysis of all significant comments and the Task Force’s responses, please refer to Agenda Item 5-A and 5-B.

Regulators and Oversight Authorities, Including MG members

1. Botswana Accountancy Oversight Authority (BAOA)

Yes, we agree.

(a) The proposed principles of the IESBA in relation to independence of individuals involved in a group audit describes the independence requirements applicable to the audit team, which is important in defining what constitutes ‘independence’.

(b) We are also in support of the definition of audit team for a group audit to be extended to include individuals within a non-network Consultative Advisory firm who can directly influence the outcome of the group audit. Although the individuals are involved on a consultative basis and are not part of the network firm, their involvement can influence the final results of the audit.

2. Committee of European Auditing Oversight Bodies (CEAOB)

Responsibility for requirements in relation to independence of the component auditor firm

We suggest clarifying in section 405 which individual in the component auditor firm is responsible for the performance of the procedures related to independence required by section 405.

We suggest adding a requirement in paragraph R405.8 for the component auditor firm outside the group auditor firm’s network to also perform inquiries or other procedures within that component auditor firm’s network to identify whether a threat to the component auditor firm’s independence exists.

3. International Forum of Independent Audit Regulators (IFIAR)

Component Auditor Firms Outside a Group Auditor Firm’s Network

We advise that IESBA considers including a requirement for component auditor firms outside the group auditor firm’s network to inform the group auditor of any relationship or circumstance that: (i) is being included, in accordance with paragraph R405.7 of the Code, when the component auditor firm is identifying, evaluating, and addressing threats to independence (regardless of whether such a threat is actually identified); or (ii) creates, or the component auditor has reason to believe creates, a threat to the component auditor firm’s independence and the component auditor firm, in accordance with paragraph R405.8, is evaluating and addressing any such threat. This will assist in applying the Code consistently across the group.

Clarity and Understandability, Including Terminology Used

(…)}
We recommend that the requirements in proposed Section 405 of the Code should specify who at the component auditor firm is responsible for performance of the procedures required under paragraphs R405.7, R405.8, and R405.15 of the Code.

(…)

4. International Organization of Securities Commissions (IOSCO)

Observations

Section 405. Group Audits

Independence Considerations Applicable to Component Auditor Firms outside a Group Auditor Firm’s Network

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Observation</th>
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<tr>
<td>405.7 and 405.8</td>
<td>These paragraphs include independence considerations for CA firms outside the group auditor firm’s network when considering relationships or circumstances involving the component audit client or the group audit client.</td>
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<tr>
<td>Observation 1</td>
<td>The proposed wording of these paragraphs limits the responsibility of such CA firms in identifying relevant relationships or circumstances to “know[ing]” or “ha[ving] reason to believe”. These limited procedures may preclude CA firms outside the group auditor firm’s network from identifying threats to compliance with the Code, including, for example, self-interest and advocacy threats. We recommend that the Code be strengthened by requiring CA firms outside the group auditor firm’s network to perform inquiries or other procedures within its network to identify and consider relationships or circumstances that may create threats to its independence.</td>
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<td>Observation 2</td>
<td>The proposed wording of these paragraphs do not require CA firms outside the group auditor firm’s network to report to the group engagement partner threats to the CA firm’s independence that are the result of a relationship or circumstance between the CA firm (or a firm within its network) and the component audit client or group audit client, assuming such threats are adequately addressed. By comparison, R405.15 requires CA firms outside the group auditor firm’s network to communicate a breach to the group engagement partner, including its assessment of the significance of the breach and any actions proposed or taken to address the consequences of the breach. We recommend that the Code be strengthened by also requiring the CA firm to communicate to the group engagement partner significant relationships or circumstances between the CA firm (or a firm within its network) and the component audit client or group audit client that create a threat to the CA firm’s independence and how such threat was addressed. Even if the CA firm was able to address any such threats at the component entity level, the group auditor should be made aware of such threats and the actions taken to evaluate and address such threats from the perspective of the group audit engagement. In addition, knowledge of such significant relationships or circumstances by the group engagement partner would allow him/her to better understand the CA firm’s processes and controls related to independence.</td>
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5. Independent Regulatory Board for Auditors (South Africa) (IRBA)

The IRBA agrees with the proposals in relation to individuals involved in a group audit.

While we appreciate the efforts of the component auditor to follow the group audit client independence requirements, we are of the opinion that the principle of applying the most stringent requirement for the group audit client should prevail and is in the public interest. This proposal is aligned to where the group audit client is a PIE, and the component audit client is a non-PIE as currently envisioned in the proposals.

In this regard we would like to highlight a possible unintended consequence where the group audit client is a non-PIE, the independence provisions that apply to the component auditor firm in relation to the component audit client, for the purpose of the group audit, are the non-PIE provisions, regardless of whether the component audit client is a PIE. Paragraph R405.9 applies this principle to a component auditor outside the group auditor firm’s network and states that: “When the group audit client is not a public interest entity, a component auditor firm outside the group auditor firm’s network shall be independent of the component audit client in accordance with the requirements set out in this Part that are applicable to audit clients that are not public interest entities.” We do not agree with these proposals.

There needs to be consideration for the practical application of this principle on the standalone audit file of the component audit client (where the component audit client is a PIE and the IESBA Code documentation will therefore be in compliance with PIE requirements), as compared to the component auditor working papers that are for the purposes of the group audit file (where the group audit client is a non-PIE and the IESBA Code documentation will therefore be in compliance with non-PIE requirements).

Further, paragraph 405.2.A2 provides a way out in the scenario of a statutory audit at a component audit client by indicating that if a component auditor firm is engaged separately to issue an audit opinion on the financial statements of the component audit client for statutory, regulatory or other reasons, the component auditor firm might need to comply with independence requirements that are different from those that would apply for the purposes of a group audit. For example, if the component audit client is a PIE and is subject to a statutory audit, the PIE independence requirements would apply for the statutory audit of the component audit client, even if the group audit client is a non-PIE.

The IRBA proposes that the principle to be applied rather be that regardless of whether the group audit client or component audit client is a PIE or non-PIE, the most stringent requirements must be applied for the purposes of the group audit, i.e., where the component audit client is a PIE, but the group audit client is a non-PIE, PIE requirements should be applied at a group level.

6. National Association of State Boards of Accountancy (US) (NASBA)

(a) NASBA agrees with the principles being proposed that align the definition of engagement team (ET) with the definition of ET in ISA 220 (Revised).

(b) NASBA agrees with the proposal that individuals involved in a group audit (GA) be independent of the audit client, including applicability of independence requirements by component audit (CA) firms within and outside the GA firm’s network. However, we have some reservations about the practicality of non-network CA firms effectively complying with the independence requirements for public interest entities (PIEs) or non-PIEs, as applicable to the group audit. We believe it would be helpful to add clarifying language for situations where the CA is potentially a PIE and under a non-PIE umbrella.

7. United Kingdom Financial Reporting Council (UK FRC)

The FRC agrees with the principles set out for individuals in relation to group audit, namely that the same independence provisions that apply to those individuals used by the Group Auditor firm and the Component Auditor firms within the network should also apply to individuals carrying out audit work at the component level from non-network firms. This aligns with the definition of the Engagement Team set out in ISA 220 (Revised).

With respect to the principles set out in relation to independence for firms engaged in a group audit (Question 4b), including Component Auditor firms both within and without the Group Auditor firm’s network,
the FRC supports the proposal to explicitly require that the Group Auditor firm’s network ensures that both the group and component audit teams be independent as set out in paragraphs R405.4 and R405.5.

We do however have reservations around reverting to the conceptual framework set out in the Code for evaluating threats for cases where the Component Auditor is auditing a PIE component within a non-PIE group. There is a risk of increased complexity for regulatory and oversight processes if one set of independence requirements are required for group purposes, and another for the audit of the component financial statements. This complexity may both create ambiguity for stakeholders, and application difficulties for component auditors. In practice, the Component Auditor may well adopt the more stringent independence requirement for the audit of the PIE component for the purposes of performing group procedures, as this is likely to be simpler in practice compared to addressing the complexities arising from this arrangement. We therefore suggest that the Code requires that group audit procedures for PIE components within non-PIE groups are required to adhere to those ethical requirements which are most stringent for both the audit engagement and the performance of group audit procedures to prevent such complexities from arising.

Public Sector Organizations

8. United States Government Accountability Office (GAO)

We believe that the independence related to individuals involved in a group audit is reasonable. We agree with the proposed independence principles as related to component auditor firms within the group auditor firm’s network. For component auditor firms outside the group auditor firm’s network, we believe that there should be additional information on how a component auditor firm should determine that a circumstance may lead to an independence threat. Paragraphs R405.7 and R405.8 address requirements broadly, but they do not make clear what communication between the group auditor firm and component auditor firm should occur. We recommend clarifying the requirement and including application guidance for such communication that should occur between the group auditor firm and component auditor firm to identify circumstances that may result in threats to independence.

Independent National Standard Setters

9. Accounting Professional & Ethical Standards Board Australia (APESB)

APESB support the overall proposed premise that consistent Independence principles be applied to all individuals and Firms engaged in a Group Audit, including component auditors, whether internal or outside the firm’s network performing the group audit engagement. We are of the view that it will meet public expectations of the independence of all auditors involved in a group audit engagement.

Stakeholders in Australia have raised concerns about the practical challenges in implementing these proposals. For example, removing the concept of materiality for components means that firms may need to monitor the independence of immaterial components, with some stakeholders questioning whether the proposed changes will contribute to audit quality. There was also a concern about whether these changes would negatively impact SMP audit practitioners as, over time, the component audits may be pushed towards the larger network firms.

Refer to the comments at question 6 below in relation to the application of the non-assurance services provisions to component auditors.

From an editorial perspective, APESB suggest the removal of the sentence ‘The ISAs apply to an audit of group financial statements.’ from the start of proposed paragraph 405.2 A1, as ISAs apply to all audits.

APESB note that many provisions in Section 405 are difficult to easily interpret due to the repetition of defined terms. Therefore, APESB suggest that the IESBA should consider simplifying the drafting to ensure the purpose/intent of the relevant provision is clear. For example, proposed paragraph 405.13 A2 is difficult to interpret but could be simplified as follows:
“In addressing the circumstances described in paragraph 405.13 A1, the component auditor firm might consider paragraphs 400.31 A2 and 400.31 A3 to assist in evaluating and addressing any threats to their independence.”

Recommendation

- Consider the development of guidance or support for SMP audit practitioners who may be faced with implementation challenges by these proposals;
- Consider the simplification of terms and language used in the revised provisions in Section 405 to enhance the ability of readers to easily understand, comprehend and interpret the provisions (refer to issues raised in Questions 1, 3, 4, 6, 7 and 8 in Appendix A)

10. New Zealand Auditing & Assurance Standard Board (NZAuASB)

Yes, the NZAuASB supports the proposals and does not have any further comments.

Professional Accountancy Organizations

11. Joint Submission -- Association of Chartered Certified Accountants/Chartered Accountants Australia and New Zealand (ACCA CAANZ)

As per para R405.10 when the group audit client is a PIE, a component auditor firm outside the group auditor firm’s network shall be independent of the component audit client in accordance with the requirements set out in this Part that are applicable to audit clients that are public interest entities’, and this is irrespective of whether the component is PIE or not. Although we understand that the intention is for both the group audit firm and component audit firm whether within or outside the network firm, to be subject to the same independence standards, we find that this can be problematic in practice and have unintended consequences. For example, such firms may not have PIE audit engagements and hence lack the experience in complying with PIE independence requirements.

Firms outside the group audit firm network, such as local SMPs, are often engaged because they provide the statutory audit service to the component, and they bring local expertise. Having to comply with the PIE independence requirements when the component is not a PIE could disincentivise such firms to be engaged as component auditors exacerbating market concentration issues, at a time where audit reforms taking place in various countries are trying to find ways to enhance competition in the audit profession.

Furthermore, this could have an impact on audit quality given that priority of component auditors within the group audit firm’s network might be given over component auditors that are outside the group auditor firm’s network, losing the local experience that component auditors outside the group audit firm’s network could bring.

We therefore suggest the IESBA to consider whether the binary approach of following the PIE independence requirements is indeed the right approach taking into consideration our concerns noted above. Instead, we suggest exploring whether following the PIE independence requirements should be based on the significance of the component to the group audit rather than a binary approach. This would ensure that in cases where the risk is high and the component is considered significant, component auditors are complying with the PIE independence requirements and where it is not, they are not required to do so, although they may be encouraged to do so.

Additionally, we find that there might be an issue of timing in relation to NAS in cases where the group is a PIE and the component is not a PIE. The component auditor may be advised to work on a component during the financial period and in some cases, they may have already provided independence impairing services given that they will now be subject to the stringent PIE independence standards, resulting in a breach. This could further impact the market concentration issue noted above.

12. Accountancy Europe (AE)

Independence principles for individuals
Members understand the rationale to have the same independence rules for all component auditors (CA) regardless of whether they are from the same network as the group auditor or not.

However, in practice it will not be workable for the CA firm outside the network to monitor individuals since the firm will not have access to the group’s structure. Additionally, it is inconsistent to require that the CA firm outside the network has to be independent from just the component audit client at firm-level, but it has to monitor the independence of their employees, who fall under the definition of the group engagement team, for the entire group structure. This seems too onerous and unnecessary, given it is very difficult to see why such individuals would need to be independent from e.g., a sister entity of their component audit client.

In addition, the language used in paragraph 76 of the Explanatory Memorandum creates the risk of undermining the quality of work done by non-network component auditors. In many jurisdictions, it is common to have non-network firms auditing certain components of the group.

**Independence principles for firms**

According to proposed paragraph R405.10, in cases where the group audit client is a Public Interest Entity (PIE), and the component audit client is not itself a PIE, the independence provisions that apply to the CA firm in relation to the component will be the PIE provisions.

This requirement is a major concern for our members as it does not seem to improve the quality of group financial statements audit and may lead to further concentration in the audit market.

Non-PIE independence rules are considered adequate to allow the CA to issue a statutory opinion on “standalone” financial statements of the component. Hence these rules should also be sufficient for the group auditor to rely on the work of the component auditor.

Members are not fully convinced that the non-PIE auditor needs to apply the requirements relating to partner rotation, obtaining the concurrence of those charged with governance, fee disclosure and Engagement Quality Reviewer as well as the requirements relating to the provision of non-audit services.

Such treatment would lead to further concentration in the audit market as it is probable that some small- and medium-sized practitioners (SMPs), who are not in the PIE market and thus not familiar with PIE-specific provisions on independence, would be forced out of the market.

13. **American Institute of Certified Public Accountants’ Professional Ethics Executive Committee (AICPA PEEC)**

PEEC believes it will be challenging for firms and individuals from a component audit firm outside of the group audit firm’s network (non-network) to maintain independence with respect to related entities of the group audit client and recommends a threats and safeguard approach be applied to non-network firms and individuals from those firms versus what is currently being proposed.

If the strict requirement is adopted, then either IESBA or IAASB should provide guidance that would address matters such as what the group auditor should communicate to these non-network component audit firms.

PEEC also believes it would be helpful to clarify that when an entity undergoes a standalone audit, the auditor would not need to comply with Section 405 when the group engagement partner concludes that the entity is not a component audit client for purposes of the group audit.

When both the group audit client and the component audit client are PIEs and each resides in different jurisdictions, PEEC recommends clarification as to which PIE requirements the component audit team should apply with respect to the group audit. In these situations, would the component auditor need to apply:

- just the PIE requirements in the component audit client’s jurisdiction;
- just the PIE requirements in the group audit client’s jurisdiction; or
- the most restrictive jurisdictional PIE requirement?
If the component audit team is required to apply the PIE requirements of the group audit client’s jurisdiction, either IESBA or IAASB should consider providing guidance about the requirements for the group auditor to communicate to the component auditor those PIE requirements to be able to achieve compliance with the different jurisdictions.

14. Botswana Institute of Chartered Accountants (BICA)

We agree with the above-proposed principles in order to differentiate and reflect the different independence requirements of the individuals and firms engaged in a group audit.

Paragraph R405.9 provides for component auditor firms outside the group auditor firm’s network to apply independence requirements for audit clients that are not public interest entities where a group audit client is not a public interest entity.

While this provision appears under the Group Audits section, it is worth concluding at the paragraph, that the provision only applies for purposes of the group audit. This would make it clear to the component audit firm to apply the relevant independence provisions where the component audit client is a public interest entity.

15. Chartered Accountants Ireland (CAI)

Section 405 requires the group auditor to be independent. It would be helpful if this requirement was reflected in and expanded on in the application material, for example Section 405.2.A1

Paragraph 405.11 A1; there is a risk that this section is interpreted as only applying to PIEs as it currently sits within the PIE sections of the standard. It would be helpful if it was moved to follow sections R405.8.

Otherwise, we agree with the proposals.

16. CPA Australia (CPAA)

(a)

CPA Australia agrees with the principles the IESBA is proposing for independence in relation to individuals involved in a group audit.

(b)

CPA Australia believes that further consideration should be given to the wording of paragraph 405.9, which notes:

R405.9 When the group audit client is not a public interest entity, a component auditor firm outside the group auditor firm’s network shall be independent of the component audit client in accordance with the requirements set out in this Part that are applicable to audit clients that are not public interest entities.

This wording seems to imply that even when a component audit client is a public interest entity, in its own right, then the component auditor need only comply with the independence requirements applicable to an audit client that is not a public interest entity. This does not consider the prospect that a component audit client may exist in a different jurisdiction to the group audit client, and that the respective jurisdictional definitions of public interest entity may differ. That is, a component audit client may not be considered a public interest entity according to the definition that exists in the group audit client’s home jurisdiction but is considered to be one in the component auditor client’s jurisdiction. In such situations, the component auditor would need to apply the appropriate independence requirements applicable to a public interest entity in the jurisdiction within which it operates.

17. Chartered Professional Accountants of Canada Public Trust Committee (CPAC)

(a) Independence in relation to individuals involved in a group audit; and

CPA Australia believes that further consideration should be given to the wording of paragraph 405.9, which notes:
The PTC agrees with the principle the IESBA is proposing for independence in relation to individuals involved in the group audit, that the independence of individuals on the engagement team outside the group auditor firm is as important as that of individuals on the engagement team within the group auditor firm and its network.

(b) Independence in relation to firms engaged in a group audit, including CA firms within and outside the GA firm’s network?

The PTC generally agrees with the principles the IESBA is proposing for independence in relation to firms engaged in a group audit, including component auditor firms within and outside the group auditor firm’s network.

Notwithstanding our overall support for the proposals, some stakeholders did question the potential proportionality and possible consequences of requiring component auditor firms to apply the PIE independence requirements for a non-PIE component and we provide these questions for the IESBA’s consideration. If the distinct component is not in and of itself material to the group audit, would it be unnecessarily prohibitive to require the component auditor firm to apply the PIE independence requirements and could this disproportionately impact small and medium practices? Further, as the group audit planning process and risk assessment is iterative, components to be audited may change over time. Is it possible that the client-practitioner engagement would be disrupted by the PIE independence requirements that may be only temporary as the group audit evolves?

The PTC also observes proposed sub-paragraphs 405.6 (b) and (c) do not include the term “group audit client” but rather include part of the definition of group audit client as “the entity on whose group financial statements the group auditor firm expresses an opinion” without making any reference to related entities included in the definition of the group audit client. This is perceived by some the stakeholders as intentional exclusion of the related entities of the group audit client by IESBA from the scope of the sub-paragraphs 405.6 (b) and (c).

In other words, it is not clear that “the entity on whose group financial statements the group auditor firm expresses an opinion” is distinct from a “group audit client”, which includes its related entities. We recommend IESBA to clarify its intention either by using the term group audit client in sub-paragraphs 405.6 (b) and (c) or by adding application material highlighting the exclusion of the related entities. If the exclusion is the approach chosen, it is important to emphasize the relevance of the conceptual framework in evaluating such interests and relationships for threats to independence. Please also see our response to Question 3, above, where we recommend additional application material in Section 405 to clarify the IESBA’s intent in developing the proposed definitions and related prohibitions.

We also suggest that the diagram included in paragraph 50 of the explanatory memorandum is very useful and recommend it be included directly in Section 405 as explanatory guidance.

18. Compagnie Nationale des Commissaires aux Comptes (CNCC)

As a matter of principle, we agree with paragraph R405.3 which requires to apply the same independence rules to individuals who are members of the group audit engagement team (through being a component auditor for example), and this, irrespective of whether they are from a network firm (i.e., a firm from the Group auditor network) or from a non-network firm.

However, when it comes to the independence rules to be applied by firms engaged in a group audit, we strongly disagree with paragraph R 405.10 of the IESBA proposal which requires applying the PIE independence rules to the non-network component auditor of a non-PIE component in a PIE Group especially for key audit partner and rotation rules (which by the way are mentioned as firm independence rules but apply to an individual).

As explained in our cover letter we consider that such a requirement is not necessary to allow proper reliance by the group auditor on the work of the component auditor and would be very detrimental to the audit market by further increasing market concentration.
It is neither necessary for the quality of the group audit nor for the independence in fact or in appearance of the group auditor.

**19. European Federation of Accountants and Auditors for SMEs (EFAA)**

We do not agree.

As we mention in our ‘General Comments’ above EFAA is especially concerned about the provisions in R405.9 regarding group audits that are not public interest entities (PIEs). Oftentimes SMPs act as component auditors for group audit clients that are not PIEs, and in some jurisdictions ensuring firm independence can be difficult, especially in jurisdictions where there are a few auditors in a certain industry or with a certain specialty.

**20. Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE)**

Yes, we share the principles proposed by the IESBA and that follow these criteria:

a. A group engagement partner assumes responsibility for verifying that those participating in the engagement comply with independence standards.

b. An audit firm of a component, if it is also an auditor of the financial statements of the component, may need to comply with two different standards of independence, and the standard applicable to the group engagement should prevail for the audit of the component.

c. All members of the group audit team shall be independent of the group audit client in accordance with these standards.

d. A group audit firm will be independent of the group audit client.

and.

e. A group audit firm network firm shall be independent of the group audit client.

**21. Hong Kong Institute of Certified Public Accountants (HKICPA)**

*Independence Considerations Applicable to Component Auditor Firms outside a Group Auditor Firm’s Network*

As proposed in paragraph R405.10, when the group audit client is a public interest entity (PIE), the independence provisions applicable to a CA firm which is outside the GA firm’s network in relation to the component audit client are the PIE provisions, even if the component audit client is not itself a PIE. Consequently, as explained in paragraph 405.12 A1, the non-network CA firm should apply the PIE independence requirements on the provision of non-assurance services to a component audit client as the group audit client is a PIE. As a result, the non-network CA firm is prohibited from providing various non-assurance services to the non-PIE entity component since it belongs to a PIE group.

We consider the proposal might result in unintended consequences, for example, the non-network firm might turn down the appointment to act as the CA firm of a PIE group so as to continue the provision of non-assurance services to the component audit client. Eventually, the proposed revisions would limit corporates’ choice of auditors and assurance services providers, potentially increasing the costs for the non-PIE entities due to having to engage different firms for audit and non-assurance services. It may intensify the concentration of audit market, which could have a negative impact to the audit quality in general.

In this connection, we recommend the IESBA to re-consider the applicability of PIE independence requirements to the non-network CA firm of a non-PIE entity component by providing exemption in particular circumstances, rather than adopting a one-size-fit-all criteria. For example, allowing components that are (i) not material in monetary terms and (ii) do not impose any significant risks to the group audit and (iii) obtained consent from the group engagement partner to apply non-PIE independence requirements. Requiring the PIE independence provisions to apply to the non-network CA firm with respect of its audit of the component as such, even if the component audit client is not itself a PIE, seems to be unduly burdensome.
To enhance clarity and align with the requirements of ISA 600 (Revised), we also suggest the Code to require the group engagement partner to take responsibility to confirm whether the CA (including non-network CA) understands and would comply with the relevant ethical requirements, including those related to independence according to the Code’s provision.

Likewise, we also suggest the IESBA to re-assess the application of PIE independence requirements to the provision of non-assurance services to a non-PIE entity component audit client of a PIE group.

We recognize that any exemptions granted may contradict paragraph 25(b) of ISA 600 (Revised) which requires the CA to apply independence requirements that apply to the group audit engagement. Accordingly, any such concessions would need to be clear to avoid misinterpretation and inconsistent application.

It would also be helpful if the IESBA could clarify, for a non-PIE component entity that belongs to a PIE group, whether the PIE independence requirements would apply to its non-network firm auditor who is not engaged to perform any procedures for the purposes of the PIE group audit.

**Fees**

We urge the IESBA to clarify whether the fee dependency provisions applicable to a PIE (paragraph R410.28) and the requirement for a firm to disclose fee-related information of a PIE client unless otherwise specified (paragraph R410.31) would, as a result of the ED, apply to a non-network CA firm of a component audit client which itself is not a PIE, but the group audit client is a PIE.

We are of the view that making public disclosure of the fee-related information of non-PIE entities would not necessarily provide any benefit on the visibility about the professional relationships between the firm and the audit client if the relevant audited financial statements are not publicly available, which is generally the case of non-PIE entities. Thus, we recommend the IESBA to re-assess their application in the context of a non-network CA firm and include explicitly in R410.31 as an exception.

**22. Instituto dos Auditores Independentes do Brasil (Ibracon)**

We agree with the principles the IESBA is proposing for question 4. (a) Independence in relation to individuals involved in a group audit. However, in relation to question 4. (b), including the CA firms from outside the GA firm’s network, we understand that additional examples should be included in Section 405 (e.g., the extension of the independence requirements for the CA including its partners, professionals, non-assurance services, possible safeguards, etc.).

**23. Institute of Chartered Accountants of Scotland (ICAS)**

Yes – we agree with the principles the IESBA is 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 CA firms within and outside the GA firm’s network. We do, however, have some comments on the proposed wording below in relation to non-network component auditor firms.

(i) Need for increased clarity in paragraph R405.7

The Explanatory Memorandum states in paragraph 50 that the last bullet (noted below) is covered by proposed paragraph R405.7:

“Non-network Component Auditor Firms

50. Taking this into consideration, the IESBA is proposing the following independence principles for non-network CA firms: …..

• In either situation where the group audit client is a PIE or where it is a non-PIE, the conceptual framework (CF) will apply with respect to all other related entities of the component audit client, based on the “reason to believe” test in the related entity principle in extant paragraph R400.20 of the Code (see paragraph R405.7).}
However, we are not convinced that paragraph R405.7 makes this sufficiently clear and therefore suggest that a reference to paragraph R400.20 in paragraph R405.7 would be helpful to users of the Code.

(ii) Reference to “an interest” and cross reference to R400.20

We also note that the Explanatory Memorandum in paragraph 54 (in relation to financial interests in other entities within the group such as an intermediate holding entity) and paragraph 60 (in relation to all other interests or relationships a non-network CA firm might have with the group audit client) states that application of the conceptual framework as specified in paragraph R405.7 provides the appropriate approach. We therefore suggest that also including reference to “an interest”, as well as cross referring to paragraph R400.20, would help cover the situations described in paragraphs 54 and 60 of the Explanatory Memorandum in paragraph R405.7.

“R405.7 When a component auditor firm outside the group auditor firm’s network knows, or has reason to believe, that an interest, relationship or circumstance involving the group audit client is relevant to the evaluation of the component auditor firm’s independence from the component audit client, or the group audit client, the component auditor firm shall include that relationship or circumstance when identifying, evaluating and addressing threats to independence (see also paragraph R400.20).”

24. Institute of Chartered Accountants in England and Wales (ICAEW)

As a matter of principle, we believe that where a group auditor firm is reliant on the work of other audit firms, the same level of independence should generally be applied to the other firms (whether within or outside the group auditor firm’s network) as to the group auditor firm.

However, we do have concerns that the proposed independence requirements in the ED might adversely impact the choice of component auditor, and in particular, the use of smaller component auditor firms that are not within a group auditor firm’s network. This is in the context of the requirements in R405.10 in relation to PIE group audit clients and situations where a group has components in jurisdictions where the group wishes the component auditor to also engage in certain non-audit services that would be prohibited for auditors of the PIE group. For example, a PIE group audit client might have immaterial components that are not considered within the scope of the group audit and the group audit client therefore employs local auditors because it is cost effective to do so and because the ethical restrictions provide greater flexibility over providing non-audit services. Sometimes, however, those immaterial components may then be scoped in on an unpredictable basis which creates challenges for the group auditor firm as the component auditor firm would then need to apply the PIE auditor independence requirements. This could disrupt the group audit process and is likely to impact a group auditor firm’s willingness to use component auditor firms outside of their network.

We consider that it is also vital that group audit entities take responsibility for ensuring that they are aware of relevant independence requirements in relation to the audit of their financial statements to help avoid disruptions to the audit process as the audit progresses. In this respect, we would encourage IESBA to ensure that they engage widely with this stakeholder group to communicate changes in relation to auditor independence and explain the ethical responsibilities placed on audit firms.

25. Institute of Certified Public Accountants of Uganda (ICPAU)

We agree with the proposals in Section 405 (Chapter 1) relating to independence of individuals involved and firms engaged in group audits, including component firms within and outside the group audit firm’s network. We believe that Section 405 will be very instrumental in aligning the Code to ISA 600 (Revised).

26. Institut der Wirtschaftsprüfer (Germany) (IDW)

(a) As we have commented in the past, we see merit in requiring all individuals involved in an audit be independent of the audit client, although we do still see an argument for the IESBA to adopt a more practicable and proportionate approach that includes de minimis exceptions in this context. The more complex the Code becomes, the more likely that isolated breaches that are inadvertent, unintentional, and insignificant will occur, even breaches that the individual is unaware of at the time of engagement performance – i.e., breaches that do not impact an individual’s independence in fact at all.
In requiring the group auditor to inform those charged with governance of all breaches the Proposal compounds the practicality issue, as this requirement will likely lead to “irritation” and a desire for simplification. We therefore suggest the IESBA should reconsider its no tolerance stance in paragraph R405.9 and consider whether a proportionate approach that includes de minimis exceptions to the independence provisions might instead be applicable to all individuals concerned with an audit.

(b) The level of stringency proposed (R405.10) should be weighed against potentially severe impacts on the audit market in determining whether the proposals as drafted are justified. The impact assessment provided in the Proposal is perfunctory and does not demonstrate a thorough consideration by IESBA of the practicalities or potential impacts of its proposals.

An individual component auditor’s involvement can vary considerably from very limited procedures on a single line item to the equivalent of a full audit, and thus a component auditor’s potential to impact the group audit opinion can vary widely. Not all component auditors can be expected to be able to directly influence the outcome of the group audit (guidance on what “outcome” is intended to mean would also be helpful). In our opinion, the relevant significance of procedures performed by a non-network component auditor to the group audit as a whole coupled with the fact that a non-network firm potentially poses a lower degree of self-review threat to the group auditor’s independence than might a network component auditor both demand a more thorough consideration, including – as suggested above – adopting a proportionate solution in finalizing the Proposal.

Whilst we acknowledge that changes to ISA 600 (Revised) are aimed at achieving a uniform high-quality performance of all procedures throughout a group audit, we suggest that the desire to govern the performance of uniformly high-quality work differs significantly from reasoning behind a desire to achieve a uniform degree of independence. The latter often boils down to perceptions of independence and has little impact on independence in fact. Furthermore, it is also not clear what “ills” the proposal that PIE independence requirements must apply to all procedures performed on any financial information of non-PIE components are seeking to fix (i.e., an evidential basis supporting the need for such stringency is missing).

Further comments on section 405:

- 405.18.A2 appears to contain two requirements (first and second sentences) but the wording of the second sentence is unclear – if the condition in the first sentence applies, the group auditor is banned from using component auditor firm’s work (i.e., this is a requirement), whereas the second sentence refers to the group engagement partner “might” find other means… Logically, this also has to be included as a requirement.
- The wording of R405.9 could be revised so as not to imply that it is unacceptable for a component auditor of a PIE component to apply independence rules for PIE entities when the group is a non-PIE. It should be possible to apply more stringent rules e.g., where these apply to the statutory audit. As drafted any implication of a ban would be counterintuitive. Thus, the wording should either refer to it not being necessary or if “shall apply” is retained it should be presented as one of two alternatives.

27. Institute of Singapore Chartered Accountants (ISCA)

Non-network CA firms

When the component audit client is a public interest entity (“PIE”) but the group audit client is not a PIE, the non-network CA firm shall apply the independence provisions that are applicable to non-PIEs for purposes of the group audit (proposed paragraph R405.9).

The proposed paragraph 405.2 A2 clarifies that a CA firm (both within and outside the network) that participates in a group audit engagement might separately issue an audit opinion on the financial statements of the component audit client. For example, if the component audit client is a PIE and is subject to a statutory audit, the PIE independence requirements would apply for the statutory audit of the component audit client, even if the group audit client is a non-PIE.
Hence, given that the non-network CA firm would already be subject to PIE rules in such situations, it does not appear that there is a strong reason to provide a “concession” for the non-network CA firm to apply the non-PIE independence rules for purposes of the group audit. In practice, we believe that the non-network CA firm would apply PIE rules consistently as it would be impractical for the firm to subject itself to a lower independence threshold for purposes of the group audit.

We are uncertain of the value in providing such a “concession” and whether it will have any impact at all on the non-network CA firm. We urge the IESBA to reconsider the proposed paragraph R405.9.

28. Japanese Institute of Certified Public Accountants (JICPA)

We agree with the principles the IESBA is proposing for (a) and (b).

29. Korean Institute of Certified Public Accountants (KICPA)

The revised Code clearly defines the independence principles for individuals and firms involved in a group audit. We agree with the way that the level of independence requirement is varied depending on whether a group audit client is a public interest entity (PIE) or not, especially when CA is not a network firm of GA, as this approach enhances public trust while ensuring compliance with proportionate independence requirements. In addition, as to whether CA should be independent of the group audit client, we agree to apply the conceptual framework with respect to related entities in line with the nature of principles-based approach of the ethics standards.

However, as highlighted by the explanatory memorandum of the Exposure Draft, the revised Code may result in significant cost related to adoption and implementation as it requires changes to practical work process. In particular, the requirement that CA should be independent of the group audit client (conceptual framework with respect to related entities, restriction on financial interest) involves significant change and cost in practical work process. We suggest considering ways to revise the Code in a manner that practical workload can be reasonably reduced.

Under the revised ISA 600, component audit may be required especially even when the materiality of a component is very low to group financial statements, as identification of a significant component is not required any more. In this case, same independence requirements must be applied even when there is no material threat to independence from group audit perspective. One possible option to consider in this context is to apply stronger independence provisions only when a component is material to group financial statements, in the same way that the extant Code’s provisions on related entities only apply to the upstream entity of a listed entity when the listed entity is material to the upstream entity, or when firms’ financial interest in an audit client’s controlling entity is restricted since the audit client is material to the controlling entity. This approach is expected to help maintain public trust in group audit while alleviating cost burden on firms (especially, small- and medium-sized practices that are mainly responsible for the audit of small components). This approach would also enhance the potential acceptance to revised independence requirements.

30. Malaysian Institute of Accountants (MIA)

(a) Independence in relation to individuals involved in a group audit; and

We agree with the principles proposed in Section 405 (Chapter 1) addressing independence in relation to individuals involved in a group audit.

(b) Independence in relation to firms engaged in a group audit, including CA firms within and outside the GA firm’s network?

Monitoring and Evaluating Compliance

We are of the view that the proposed new section lacks clarity and guidance relating to monitoring and evaluation of compliance with the proposed new requirements.

We suggest that the IESBA Code should explicitly outline the responsibilities of the component auditor in complying with the relevant ethical requirements and how the GA should monitor and evaluate the component auditor’s compliance. This should include:
a. the period that the group auditor is required to monitor and evaluate the component auditor’s compliance with the relevant ethical requirements (i.e., before and during the engagement, as well as prior to the group auditor issuing the group auditor’s report),

b. the component auditor’s responsibilities in relation to the minimum acceptable communication with the group auditor (i.e., before and during the engagement, as well as prior to the group auditor issuing the group auditor’s report), and

c. the minimum information that the group auditor is required to obtain to evidence the component auditor’s compliance.

Key Audit Partner

Paragraph 405.11 A1 is proposed as application material to highlight that the group engagement partner might determine that an engagement partner who performs audit work related to a component for the purposes of the group audit is a key audit partner. Our understanding is that this was included as an application material instead of a requirement because the group engagement partner applies professional judgment to identify key audit partners from a group perspective based on the facts and circumstances. This may have unintended consequences and result in inconsistent application by group engagement partners.

The IESBA Code currently includes a definition for Key Audit Partner and requirements to which the Key Audit Partner must comply. However, there is no requirement or application material for a specific individual or body to determine who the Key Audit Partners are. Proposed paragraph 405.11 A1 therefore appears to be out of line, in aligning the independence considerations in a group context to the existing requirements of Part 4 of the IESBA Code.

We suggest that Section 405 follow the same approach as the extant IESBA Code:

a. Define a Key Audit Partner from a group audit perspective, and

b. Include a requirement for all Key Audit Partners engaged in the group audit and their firms to comply with the requirements set out in paragraphs R411.4 and R524.6, as well as section 540.

Scalability of Requirement For a PIE/Non-PIE Engagement

We are of the view that there may be difficulties for component auditors to adhere to the broader independence requirements as currently proposed. To elaborate, a component auditor would generally perform the statutory audit for a non-PIE component company in conjunction with any other procedures required for reporting purposes to the group auditor. The component auditors would have performed the statutory audit in accordance with non-PIE independence requirements (which could mean providing certain allowed non-assurance services). This would then possibly introduce complexities if required by the group auditors to then adhere to PIE independence requirements instead since the parent company is a PIE. The reverse situation is less of an issue.

We note that it would be impractical to apply such stringent requirements to a component auditor who is eligible to perform the statutory audit in their respective jurisdiction but not procedures for a group audit. This could possibly lead to duplication of work and questions regarding the necessity of such work if the group auditor must approach a separate component auditor to perform the procedures required for the group audit or perform such work themselves.

Rather than strictly require all work by the component auditor to be performed under PIE independence requirements in R405.9 -10, we would therefore, suggest introducing a scalable approach for the group auditor to consider the qualitative and quantitative significance of the work performed on a component to influence the outcome of a group audit, such as the consideration of:

a. the materiality of the component audit client to the group audit client, and

b. the level of influence that the component auditor firm can exert on the group audit opinion.
Such an approach will also be in line with how breaches to the Code is to be evaluated and dealt with under paragraph R405.15 (b) and (c) while paragraph R405.17 espouse on the need to exercise professional judgement, using the reasonable and informed third party (RITP) test.

We believe the wording of R405.9 should also be revised so as to be clear that it does not imply that it would be unacceptable for a component auditor of a PIE component in a non-PIE group to apply independence rules for PIE entities when the group is a non-PIE. It should be possible to apply more stringent rules (e.g., where these apply to the statutory audit) but not the other way around. As potentially implied by the wording – an outright prohibition would be counterintuitive. The component auditor firm should be given the flexibility to decide in such a situation.

31. Royal Nederlandse Beroepsorganisatie van Accountants (NBA)

In principle, we do agree. However, we believe, as well as AE, that the application of the PIE independence rules to the non-network accountant of a part of a PIE Group (itself being non-PIE) is not a good development in specific for PIEs that are subject to European regulations.. We believe this could lead to further concentration of the audit market specifically in Europe. After all, the other new independence rules in addition to the existing rules regarding the adjustments of the Non-audit services (NAS) already provide sufficient guarantees for an independent audit. There is also the requirement of applying the conceptual framework. We therefore do not support application of the PIE independence rules to the non-network accountant of a non-PIE part of a PIE Group in R405.10.

In order not to directly transpose and apply the independence rules of the PIE to the component auditor at a non-PIE, we believe that the non-PIE independence rules are considered sufficient for the non-PIE component for independent statutory purposes. At PIE group level, the conceptual framework approach should then be suffice.

Finally, we have an additional point regarding the new NAS independence rules for PIEs have dropped the materiality criterion in the event of a threat of self-assessment. This therefore also affects the non-PIE component audit client. This creates the special situation that at the component audit client level a NAS could be provided because it has no material influence on the figures of the component audit client, but the same NAS for this component audit client is prohibited from the group audit requirements due to a threat of self-assessment (due to lack of materiality criterion for PIEs).

32. New York State Society of CPAs (NYSSCPA)

33. South African Institute of Chartered Accountants (SAICA)

In principle we agree with the proposals, however, there are also other considerations that IESBA needs to make. As mentioned in paragraph 1(a) and (b), there are scenarios where the group engagement team may not have influence of the scope of activities and independence requirements of the component auditor. The Code should provide guidance in these situations as different jurisdictional requirements could apply.

In drafting the proposed amendments to the Code, the IESBA also needs to be considerate of the broader issues relating to market concentration, particularly in a developing economy such as South Africa. For example, you may get situations where a component auditor, although performing a PIE audit may still perform procedures limited to certain sections of the audit that may not have a significant impact on the group opinion. It would be onerous in these instances to expect the component auditor to comply with the stricter requirements of PIE audit engagements.

Guidance should be provided in the Code explaining those instances where a component auditor has significant influence in the audit. Different requirements should apply based on the level of influence that a component auditor has on the group engagement rather than using a blanket PIE requirement. Furthermore, we would like to highlight the fact that PIE is not consistently defined across all jurisdictions. For example, in South Africa the Independent Regulatory Board for Auditors (IRBA) is currently revisiting the PIE definition for the local environment and they may not be consistent with definitions in other jurisdictions.
No guidance is provided with regards to shared audits and whether the non-signing party should be included in the independence requirements. A possibility is that these parties could be service providers to the main auditor, however, given that they are directly involved in the execution of audit procedures they would be correctly categorised as members of the engagement team. We encourage IESBA to provide explicit guidance regarding shared audits is this is a tool used globally to address the market concentration challenge.

34. South African Institute of Professional Accountants (SAIPA)

The IESBA is proposing that the same independence provisions that apply to individuals from the GA firm and CA firms within the network should apply to individuals carrying out audit work at the component level from non-network firms. The IESBA is of the view that the work of the individuals from the non-network CA firms contributes to the audit opinion on the group financial statements just as much as the work performed by individuals from the GA firm and CA firms within the network.

Therefore, given that the expanded definition of ET captures individuals from non-network CA firms and other service providers, the IESBA is proposing a single requirement that all members of the audit team (which includes the ET) for the group audit be independent of the group audit client in accordance with the requirements of Part 4A that are applicable to the audit team.

By taking a consistent approach to personal independence, whether an individual is from a network firm or a non-network firm, the IESBA intends to eliminate any perception that the independence of individuals on the ET outside the GA firm and its network is less important than that of individuals on the ET within GA firm and its network.

We agree with the principles the IESBA is proposing Independence in relation to individuals involved in a group audit.

With respect to the GA firm, a requirement to be independent of the group audit client in accordance with the requirements of Part 4A that are applicable to the firm. With respect to network CA firms, a requirement to be independent of the group audit client in accordance with the requirements of Part 4A that are applicable to the network firm. The key matters the IESBA has then sought to address is to establish principles applicable to firm independence concerning CA firms outside the GA firm’s network.

We agree with the principles the IESBA is proposing on Independence in relation to firms engaged in a group audit, including CA firms within and outside the GA firm’s network.

35. The Society of Certified Accountants and Auditors of Kosovo (SCAAK)

We do not agree.

SCAAK is especially concerned about the provisions in R405.9 regarding group audits that are not public interest entities (PIEs). Oftentimes SMPs act as component auditors for group audit clients that are not PIEs, and in some jurisdictions ensuring firm independence can be difficult, especially in jurisdictions where there are a few auditors in a certain industry or with a certain specialty.

36. Federation of Accounting Professions, Thailand (TFAC)

Yes, we agree.

37. Wirtschaftsprüferkammer (Germany) (WPK)

We don’t agree.

In our view the Requirement in R 405.9 (“Group Audit Clients that are Not Public Interest Entities”) is a particular hurdle for SMPs because SMPs often act as component auditors for group audit clients that are not PIEs. It might be problematic ensuring that an audit firm is independent, particularly in jurisdictions with a limited number of auditors in a certain sector or with specific skills.

It is proposed in R 405.10 (“Group Audit Clients that are Public Interest Entities”) that ,When the group audit client is a public interest entity, a component auditor firm outside the group auditor firm’s network shall be
independent of the component audit client in accordance with the requirements set out in this Part that are applicable to audit clients that are public interest entities.”.

In principle we agree with the IESBA that the same ethical requirements apply to non-PIE component auditors as to the Group Auditor of the PIE. However, this requirement does not consider any aspects regarding the size, complexity or extent of work performed by the component auditor. Therefore, we are convinced that at least adequate aspects of scalability should be included within this requirement. Otherwise there is an increasing risk that SMP statutory auditors will be excluded from all work relating to the component, although they are accepted as local statutory auditor. We are therefore concerned that the proposed independence requirements will discourage many SMP-component auditors from doing audit work, especially to small components.

Both requirements (R 405.9 and 405.10) could lead to a complete abandonment of local audits in order to continue to rely on the local auditor as a consultant or similar.

Firms

38. Association of Italian Audit Firms (ASSIREVI)

Section 405 (chapter 1) extends the independence requirements applicable to the GA to the CA firms within and outside the GA firm’s network. The proposal will inevitably enlarge the perimeter of the affected entities not only to the controlled or controlling entities with respect to the audited entity, but also to all the related entities within the audited group. Therefore, the new requirements extend the IESBA independence requirements to audit firms that are not part of the GA firm’s network also where the same CA carries out only limited audit procedures or audit procedures on a limited or not material part of the audited group. In Assirevi’s view, the IESBA’s proposal extending the independence requirements outside the GA firm’s network does not appear to be advisable, in particular where the CA engagement partner of the CA firm outside the GA firm’s network is not identified as a key audit partner by the GA.

In practical terms the proposed Section 405 will force the CA firm outside the GA firm’s network to further expand independence verification procedures to a much broader perimeter, including entities (i.e. all the related entities) where any threats to the auditors’ independence can be reasonably excluded upfront. An inevitable side effect of such new independence provisions for CA outside the GA firm’s network will be to discourage audit firms to enter in the audit of a large PIE group when they are not GA. Assirevi suggests therefore that the scope of the independence rules required by the IESBA Code for CA firm outside the GA firm’s network and for the individuals of that CA firm should be reviewed and restricted only to the controlled entities of the company audited by the CA firm outside the GA firm’s network.

In our view, it is appropriate for independence rules to cover the PIE parent company and its related entities. However, our concern is referred to the applicability to the component’s related entities. In particular, we believe that, at the component level, a balanced solution could be achieved by restricting the relevant perimeter to the component’s controlled entities, while excluding other related entities, such as controlling entities and sister companies. On the subject of financial interest and financial relationships, we refer to our response under no. 5 below.

39. BDO International Limited (BDO)

Independence in relation to individuals involved in a group audit

BDO agrees with the principles proposed in Section 405 (Chapter 1) addressing independence in relation to individuals involved in a group audit.

Independence in relation to firms engaged in a group audit

BDO agrees that independence in relation to firms engaged in a group audit needs to be addressed, however how this will be practically implemented and monitored is not clear.

Furthermore, the need for the group engagement partner to understand the different audit methodologies across firms that do not form part of the same network will reduce audit efficiencies and increase the costs of a group audit.
It will be particularly challenging for the group engagement partner to supervise the work performed by a component auditor firm outside the group auditor firm’s network where the group engagement partner has no authority over these individuals and when different audit methodologies are applied.

Refer to paragraph 38 for BDO’s suggestion relating to practical guidance that will be useful in relation to how group auditor firms monitor financial interests and loans & guarantees held by component auditor firms outside the group auditor firm’s network in the group audit client and the extent to which group auditors can rely on the component auditor’s ISQM 1 system of quality management

Independence in relation to firms engaged in a group audit- monitoring and evaluating compliance

BDO is of the view that the proposed new section lacks clarity and guidance relating to monitoring and evaluation of compliance with the proposed new requirements.

To this end, BDO suggests that the IESBA Code explicitly outlines the responsibilities of the component auditor in complying with the relevant ethical requirements and how the group auditor should monitor and evaluate the component auditor’s compliance. This should include:

a. the group auditor’s responsibilities in terms of the frequency of monitoring and evaluating the component auditor’s compliance with the relevant ethical requirements (i.e., before and during the engagement, as well as prior to the group auditor issuing the group auditor’s report),

b. the component auditor’s responsibilities in relation to the minimum acceptable communication with the group auditor (i.e., before and during the engagement, as well as prior to the group auditor issuing the group auditor’s report),

c. the group auditor’s role in identifying threats relating to the provision of non-assurance services to group audit client or the component audit client,

d. the minimum information that the group auditor is required to obtain to evidence the component auditor’s compliance, and

e. whether the monitoring and evaluation would also extend to the component auditor’s use of others (such as EQ Reviewers, service providers).

Independence in relation to firms engaged in a group audit – Key Audit Partner

Paragraph 405.11 A1 is proposed as application material to highlight that the group engagement partner might determine that an engagement partner who performs audit work related to a component for the purposes of the group audit is a key audit partner. Our understanding is that this was included as application material instead of a requirement because the group engagement partner applies professional judgment to identify key audit partners from a group perspective based on the facts and circumstances. This may have unintended consequences and result in inconsistent application by group engagement partners.

The IESBA Code currently includes a definition for Key Audit Partner and requirements with which the Key Audit Partner must comply. There is no requirement or application material for a specific individual or body to determine who the Key Audit Partners are. Proposed paragraph 405.11 A1 therefore appears to be out of line, in aligning the independence considerations in a group context to the existing requirements of Part 4 of the IESBA Code.

To this end, BDO suggests that Section 405 follow the same approach as the extant IESBA Code:

a. Define a Key Audit Partner from a group audit perspective, and

b. Include a requirement for all Key Audit Partners engaged in the group audit and their firms to comply with the requirements set out in paragraphs R411.4 and R524.6, as well as section 540.
**40. Deloitte Touche Tohmatsu Limited (DTTL)**

While Deloitte Global is in general agreement with the proposal to extend the application of independence requirements to individuals from a non-network firm who are carrying out the audit work at the component level, the current proposal is too extensive in some respects.

In Deloitte Global’s view, individuals from a non-network CA firm should be required to be independent only of the component audit client and the entity on whose group financial statements the group auditor expresses an opinion. We do not consider that any real threats to the independence of an individual at the non-network CA firm are created from relationships with other related entities of the group audit client, such as a sister entity of the component audit client. Placing independence requirements on individuals from a non-network CA firm (as well as their immediate and close family members in certain cases) would be administratively onerous given the need to remain apprised of changes to the broader group structure, and we believe without level benefit. We encourage the Board to consider a more balanced approach in this area that would focus independence requirements on relationships with those entities that are more likely to threaten the individual’s independence.

As it relates to independence of firms engaged in a group audit, Deloitte Global agrees that both the GA firm and the CA firm within the GA firm’s network should be independent of the group audit client (subject to our comments above with respect to the definition of group audit client) as specified in the extant Code. We also support the general principle that the group audit client’s PIE or non-PIE status would determine whether the CA firm outside of the GA firm’s network is required to be independent of the component audit client under the PIE or non-PIE rules, as well as the principle of applying the conceptual framework to any other related entity of the component audit client, aligned to the extant provision in R400.20.

Notwithstanding the above, Deloitte Global believes the Code should clearly state which PIE-related requirements apply to a non-network CA firm at a non-PIE component audit client where the group audit client is a PIE. These would include the prohibition of certain non-assurance services and the long association requirements (if the CA engagement partner were determined to be a Key Audit Partner with respect to the group audit). The Code should also explicitly state the requirements that would not extend to non-network CA firm, such as concurrence of those charged with governance under the new non-assurance standard or the fee disclosure under the new fees standard, both of which are focused on a firm and its network firms.

**41. Grant Thornton International Ltd (GTIL)**

(a) Independence in relation to individuals involved in a group audit; and

We believe the independence requirements applicable to individuals at a component audit firm outside the group audit firm’s network should not be the same personal independence requirements as applied to individuals from the group audit firm and within the group audit firm’s network.

While a component auditor may be key to a group audit engagement, they generally do not have access (or professional working relationships with) other management teams or audit committees outside of the component entity (e.g., group audit client or sister entities) for which they are performing procedures for purposes of the group audit. Furthermore, they are not involved in the planning or determining the group audit strategy for purposes of providing an opinion on the group financial statements. Since it is the group auditor that takes responsibility for the overall group audit strategy and the audit evidence to support the group audit opinion, including the work performed by the component auditor, it is expected that the independence requirements for the engagement team of the group audit firm are higher. This is an important distinction, particularly with respect to independence, regulatory, and other legal considerations that may exist across the globe.

The proposed provisions to the Code in this area may make it increasingly difficult for component auditors from a firm other than the group audit firm’s network to be used on the audit engagement and/or even operationalize the proposed revisions. The consequence of this may be that group audit engagements will increasingly be performed only by the larger firms and such a concentration of the market we believe is not in the public interest.
We believe the requirements for these individuals should be more aligned with the proposed independence requirements for component audit firms outside the group audit firm’s network, in that the conceptual framework would be applied when evaluating relationships that are known or have been identified with certain related entities within the group. We believe the application of the conceptual framework when analyzing independence matters with these related entities is more appropriate because:

- component audit teams of non-listed PIEs will be unaware of certain related entities, such as brother-sister entities, of their component audit client since they don’t meet the IESBA related entity definition for these entities, and
- component audit firms can operationalize a conceptual framework approach across their firm which would allow the firm to incorporate the appropriate procedures to monitor the engagement teams’ personal compliance with respect to the relevant entities. This approach will better enable component audit engagement teams to report their independence with these entities to the group audit engagement partner.

We would encourage IESBA to better understand the impact these proposed provisions may have on firms today while taking into consideration the level of independence risk that exists with component audit engagement team members and identified or known instances of non-compliance by component audit engagement team members that has impacted the issuance of a group audit report by the group auditor due to independence.

(b) Independence in relation to firms engaged in a group audit, including CA firms within and outside the GA firm’s network?

GTIL agrees with the principles the IESBA is proposing in Section 405 regarding independence in relation to firms engaged in a group audit, including CA firms within and outside the GA firm’s network.

42. Ernst & Young Global Limited (EY)

We agree with the principles being proposed for the independence in relation individuals involved in a group audit and to firms engaged in a group audit, including component auditor firms within and outside the group auditor firm’s network.

With regard to the independence of individuals involved in a group audit, in order for individuals from outside the group auditor firm’s network to comply with the independence provisions that are applicable to individuals from the group auditor firm and its network, the engagement team for the group audit will need to inform the non-network component team of all related entities for which personal independence is required. We note that this is currently not addressed in the IESBA’s proposals and is not required under International Standard on Auditing 600 (Revised), Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) (ISA 600R). We suggest that application material be included to explain the need for the group auditor firm to provide such information to the component auditor firm outside the group auditor firm’s network.

43. KPMG IFRG Limited (KPMG)

We do not agree with the proposed requirement vis-à-vis paragraph R405.3 for individuals from a non-network component auditor firm who are involved in the group audit to be independent of the related entities of the group audit client, especially parent and sister entities for a listed group audit client. We believe that the risk of threats being at an unacceptable level for individuals from a non-network component auditor firm due to relationships with, financial interests in or access to confidential information at these related entities is very low. This requirement, which is not standard practice currently, would result in overly complicated processes and procedures to ensure compliance at the component team that may not be practical to implement and could result in the component auditor and group auditor inadvertently breaching these rules.

Concerns regarding compliance with this requirement for individuals from a non-network component auditor firm include:
• Difficulty for non-network firms in obtaining timely information on related entities of the group audit client, especially due to mergers and acquisitions, leading to breaches of personal independence rules;

• Limitations of the number of audit firms that could perform the component work due to the need to restrict sister entities of the group audit client. This may lead to increased audit costs without improving overall audit quality;

• Enhancement of systems to track related entities that only certain individuals in a component auditor firm need to be prohibited from investing in or having relationships with.

While we believe that this requirement should not be retained, in the event that the requirement for individuals from a non-network component auditor firm to be independent of the group audit client and its related entities is retained, we recommend that this point be overtly clear in Section 405, as it was difficult to easily surmise the intent from the current language in R405.3.

44. Mazars Group (MAZARS)

• The proposed definition of Key audit partners in 405.11A1 includes the wording ‘might determine’ in relation to the identification of a key audit partner at a component level. We wonder whether this is relevant because a Key audit partner-status ‘automatically’ exists following the explanation in its definition as it relates to individuals who makes key decisions or judgements on significant matters.

• In R405.10 it is described that a component auditor firm outside the group auditor firm’s network, in the case of a group audit client that is a Public Interest Entity, has to be independent of the component audit client in accordance with the requirements, set out in this Part of the ED, that are applicable to audit clients that are public interest entities. However, for us it is not clear to what extent the independence rules have to be applied. For example, are the rotation rules for Engagement Partner applicable to PIEs to be followed? We suggest that you clarify what is meant by the “proportionate approach that avoids unintended consequence of potentially limiting supply of CA firms for audits of components for group audit purposes” which you referred to in your global webinar.

45. MNP LLP (MNP)

46. PKF International Limited (PKF)

We agree with the proposals in Section 405 relating to (a) and (b) above.

47. Pitcher Partners (PP)

The extension of the independence requirements to all elements of an audit is complex. Further it has the potential to minimise competition as ensuring independence under the revised definitions is more complex and therefore utilising non-network firms is even less attractive, consequently, the proposed definitions and principles are anti-competitive, and potentially reduce audit quality by limiting the available firms to a client for their audit.

As the group auditor identifies the components in some cases after engaging, based on facts and circumstances, there is a high likelihood that smaller components will have independence breaches as soon as they are scoped in, particularly with the PIE matter making all subsidiaries PIE if the parent is. Further how does this work for an intermediary entity which may be a PIE at that level but the overall parent may not be a PIE.

Further the reasonable informed party test is in practice applied with hindsight and in a review or litigation environment in most instances and is an open area for disagreement, particularly where regulators consider themselves to be the sole determinant of a reasonable informed party.

48. PricewaterhouseCoopers International Limited (PWC)

In relation to individuals:
We agree that these changes are necessary to give clarity to the application of applicable requirements in ISA 220 (Revised) and ISA 600 (Revised) resulting from the revision of the definition of the engagement team.

We agree in principle that there should be no distinction between the independence requirements that apply to individuals at the component level based on whether they are from a network or non-network component auditor firm. However we are concerned that the proposals are not proportionate to the level of threat for individuals outside the Network and would recommend that the Board give consideration to modifying the requirements for component auditors.

We recommend that if the group audit client is a listed entity that the definition of group audit client for this purpose could reasonably exclude upstream entities of the group audit client and its downstream significant influence associated entities. This would be a specific refinement of the application of R400.20 for this purpose.

This would align with the requirement in the case of a non-listed PIE where such individuals are required to be independent of (a) the component entity and (b) the PIE group audit client and its other controlled entities/components.

In both scenarios, personal independence of any other related entity of the group audit client, including its upstream entities, would be evaluated only on a “knows or has reason to believe” basis in line with the conceptual framework.

We believe that this would be a proportionate response, bearing in mind this applies to all components irrespective of materiality and impact on the group financial statements, and that the distinction between listed and non-listed PIEs does not seem to be an important differentiator in this regard. The existence and level of any threat arising from an interest in an upstream entity of the group audit client or an “associated” entity is more remote (especially when the scope of the component audit work is limited e.g. attending a stock-take).

We also believe that such a refinement would help with potential systems and information access limitations, especially for SMPs acting as component auditors (see general comment below), and would ultimately be in the public interest.

In relation to the firm:

We agree that in relation to its audit of the component audit client:

- when the group audit client is a PIE, the independence provisions that apply to the non-network component auditor firm in relation to the component audit client for purposes of the group audit are those applicable to PIEs; and
- when the group audit client is a non-PIE, the independence provisions that apply to the non-network component auditor firm in relation to the component audit client for purposes of the group audit are those applicable to non-PIEs. As stated in the Standard, PIE provisions would apply to the component audit client in respect of any component statutory audit if the component audit client is itself a PIE.

Others

49. IFAC Small and Medium Practices Advisory Group (IFAC SMPAG)

The proposed requirement of R405.10 regarding group audits that are public interest entities is particularly concerning for SMPs. In many cases, SMPs who are not part of the group auditor’s network perform a required statutory audit for a group company that is not a PIE in their jurisdiction and may also act as component auditors for group audits involving procedures on the financial information of these components. Requiring such component auditors to adhere to independence requirements applicable to public interest entities may be appropriate when such auditors perform significant audit procedures such that their work can directly influence the outcome of the group audit, but this requirement should not be extended to be applied as broadly as is proposed. The SMPAG found the spirit behind 405.12 A2 to be
helpful, but we believe that perhaps it should be moved to a requirement rather than in the application material such that its authority is clear – essentially it is a negative requirement.

In practical terms, an SMP (who is not a member of the group auditor’s network) who is the statutory auditor of a non-PIE component will have performed the statutory audit applying the non-PIE independence requirements (i.e., the provision of specific allowed non-audit services and the lower required threshold for audit fees) but may be rendered “ineligible” to undertake any work whatsoever on the component for the group audit. It seems overly stringent to preclude such a firm who is considered sufficiently independent to perform a statutory audit of a full set of financial statements of the component from performing even minimal procedures - especially if the component is not of high significance to the group.

The SMPAG believes that, in determining whether the proposals as drafted in R405.10 are justified in all cases, IESBA must weigh the level of stringency proposed in R405.10 against potentially severe impacts on the audit market– and possibly leading policy makers to question both the need for duplication of work and the value of statutory audits. Specifically, not taking account of the relevant significance of procedures performed by non-network component auditors, nor the fact that a non-network firm does not pose the same degree of independence threat as would a network component auditor, is questionable.

In conclusion, we urge the IESBA to develop a scalable approach that recognizes the relative significance to the group audit of the relative ability of procedures performed by a non-network component auditor to directly influence the outcome of the group audit. This would be instead of requiring all work by a non-network component auditor (on even a single item in the financial statements of a non-PIE component) be performed under the PIE ethical requirements when the parent company is a PIE.

We believe the wording of R405.9 should be revised so as to be clear that it does not imply that it would be unacceptable for a component auditor of a PIE component in a non-PIE group to apply independence rules for PIE entities when the group is a non-PIE. It should be possible to apply more stringent rules (e.g., where these apply to the statutory audit). As potentially implied by the wording – a ban would be counterintuitive. Thus, the wording should clarify that adherence to non-PIE rules is required and thus adherence to PIE requirements is not necessary or similar. For example, you need to apply PIE rules regarding long association and fees on the component audit, but not on the work done for the purpose of the (non-PIE) group audit. Some examples could be helpful.