Compilation of Comments to ET/GA ED – Question 5

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 5** 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

Concerning non-network CA firms, do you agree with the specific proposals in Section 405 regarding:

(a) Financial interest in the group audit client; and

(b) Loans and guarantees?"

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

Regulators and Oversight Authorities, Including MG members

1. Botswana Accountancy Oversight Authority (BAOA)

Yes, we agree.

(a) The explicit prohibition of financial interest in the group audit client will help in eliminating or reducing threats during audit assignments.

(b) The specific proposals are aligned to Section 511 of the code, this is important in dealing with loans and guarantees as this will ensure that public interest is better served with minimal threats.

It is, therefore, appropriate that such interest be identified and disclosed, and where possible such firms should not be engaged in the Audit.

2. Committee of European Auditing Oversight Bodies (CEAOB)

3. International Forum of Independent Audit Regulators (IFIAR)

4. International Organization of Securities Commissions (IOSCO)

5. Independent Regulatory Board for Auditors (South Africa) (IRBA)

In general, the IRBA agrees with the specific proposals in Section 405 regarding financial interest in the group audit client as well as loans and guarantees. However, we recommend that:

- Paragraph R405.6b be applicable to the component auditor who has a direct or material indirect financial interest ***in any*** entity within the group whose financial information is included in the group financial statements.
- Paragraph R405.6c be applicable to the component auditor who has material loans and guarantees from ***any*** entity within the group whose financial information is included in the group financial statements.

Further, the IRBA proposes that the group engagement partner and/or group auditor firm should monitor compliance with proposed paragraph R405.6 by a component auditor firm outside the group auditor firm's network through an independence confirmation.

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

(a) NASBA agrees with the proposal that prohibits non-network CA firms from holding a direct or material indirect financial interest in the entity that controls the audit client, regardless of whether the audit client is a PIE.

(b) NASBA believes that the conceptual framework (CF) provides a sufficient principles-based approach to identify, evaluate and address independence threats that might be created with respect to non-network CAs.

7. United Kingdom Financial Reporting Council (UK FRC)

The FRC supports the inclusion of explicit prohibitions on audit firms holding financial interests or issuing loans and guarantees, but we do not believe that the specific proposals go far enough. Component Auditor firms should not have financial interests with any entities within the group in which the component sits. The component auditor should be independent of the group audit client, regardless of whether they are part of the group audit firm's network or not. Failing to do so creates risks over public perceptions of the Component Auditor's independence and may therefore have negative consequences for overall confidence in the financial audit process.

Public Sector Organizations

8. United States Government Accountability Office (GAO)

We agree with the proposals in section 405 regarding holding a financial interest in the group audit client and holding loans and guarantees of the group audit client.

Independent National Standard Setters

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

APESB agree with the specific proposals in Section 405 regarding the application of the requirements relating to a financial interest in the group audit client and loans and guarantees by non-network component audit firms.

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)

We generally agree with the proposals, however, some of our stakeholders raised concerns as to whether the additional cost and work effort of managing independence will outweigh any uplift in audit quality for smaller entities and smaller component auditors and as noted in our response to Q4 could actually damage audit quality to some extent.

12. Accountancy Europe (AE)

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

(a) Financial interest in the group audit client?

PEEC supports the restrictions regarding non-network component audit firms' financial interest in the group audit client.

(b) Loans and guarantees?

PEEC supports the restrictions in proposed section R405.6(c) that references back to section 511 of the IESBA code.

14. Botswana Institute of Chartered Accountants (BICA)

We agree with the introduction of an explicit prohibition on non-network CA firms from holding a direct or material indirect financial interest in the entity on whose group financial statements the GA firm expresses an opinion as per paragraph R405.6(b)) in respect of both PIE and non-PIE group audit clients. This will reduce any potential threats and ensure consistency to paragraph R510.6 that prohibits a firm and its network firms from holding a direct or material indirect financial interest in an entity that controls the audit client, regardless of whether the audit client is a PIE.

We further agree with the Board's view for loans and guarantees between the non-network CA firm and an intermediate holding entity or any other related entities of the group audit client, to have a robust, principles-based approach to identify, evaluate and address any threats that might be created in such situations. Applying the prohibitions in Section 511 on loans and guarantees only with respect to the group audit client as per paragraph R405.6(c)) is therefore reasonable.

We note, however, that paragraph R405.6 (b) prohibits component auditor firm outside the group auditor firm's network from holding a direct or material indirect financial interest in the entity on whose group financial statements the group auditor firm expresses an opinion.

It may appear from this requirement that component clients (subsidiaries) whose financial statements are included in the group financial statements are excluded from the prohibition. It may also be interpreted, however, that the prohibition applies to the entire group as the audit opinion is expressed on the group as a whole. This varied interpretation will create application conflicts.

It is therefore worthwhile to make the prohibition clear to apply to the entire group including the component clients. As the opinion is expressed on the group, it is important for the component auditors to not have any direct or material indirect financial interest on component clients.

15. Chartered Accountants Ireland (CAI)

We agree with the proposals.

16. CPA Australia (CPAA)

(a)

CPA Australia agrees with the specific proposals regarding financial interests in the group audit client.

(b)

CPA Australia agrees with the specific proposals regarding loans and guarantees.

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

(a) Financial interest in the group audit client; and

The PTC agrees with the proposed prohibition on non-network component auditor firms from holding a direct or material indirect financial interest in the group audit client because a non-network component auditor firm's independence from the component audit client can be threatened by such financial interest. Also, since the extant Code specifically prohibits network firms from holding a direct or material indirect financial interest in a group audit client, the proposed prohibition would bring alignment and consistency with respect to non-network component auditor firms.

(b) Loans and guarantees?

The PTC observes that in proposed paragraph R405.6 (c), there is a reference to Section 511 however it may not be clear to a non-network CA auditor firm which requirements and application material of Section 511 are relevant to them as there is no reference to non-network CA auditor firm under Section 511. For greater clarity, we recommend that the IESBA consider either:

- Expanding this proposed requirement to say, for example: “Shall, in relation to Section 511 [,…] apply the relevant specific requirements and application material with respect to the Group Audit Client as if they are a network firm...” ; or
- Making conforming amendments to Section 511 to include non-network CA firms in the requirements.

18. Compagnie Nationale des Comissarias aux Comptes (CNCC)

We agree.

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

We agree.

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

(a) We agree that non-network CA companies should not hold a significant direct or indirect financial interest in the entity on whose group financial statements the group auditing firm expresses an opinion. Likewise, we agree with the proposed actions in the event that the component auditor finds a non-compliance with respect to this restriction.

(b) Yes. We agree that non-network CA companies comply with the relevant provisions regarding the existence of loans and guarantees.

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

Proposed paragraph R405.6(b) states that a CA firm outside the GA firm’s network shall not hold a direct or material indirect financial interest in the entity on whose group financial statements the GA firm expresses an opinion.

While the proposed paragraph R405.6 is similar to the Code’s extant paragraph R510.6 (except that the materiality of the component audit client to the group audit client is not considered), it is unclear whether relevant requirements and application material with respect to financial interest in section 510 applies to the context of the proposed paragraph, for example,

- Whether the assessment of “materiality” referred to in the proposed paragraph R405.6 should follow the relevant provisions in section 510;
- Whether paragraphs R510.4 to R510.9 apply to the context of the proposed paragraph R405.6 as to the capacity that the financial interest is held; and
- Whether the application materials from paragraphs 510.10 A1 to 510.10 A13 “Financial Interests – Other Circumstances” apply to the context of the proposed paragraph R405.6.

It is also not clear whether a non-network CA firm should also not hold a direct or material indirect financial interest in other components of the group, such as the subsidiary, associate or joint venture companies of the parent entity.

We recommend the IESBA to provide clarification on the applicability of section 510 to the proposed paragraph R405.6 and with respect to the above.

22. Instituto dos Auditores Independentes do Brasil (Ibracon)

Similar to question 4 above, we understand that additional examples should be included in the respective section taking into consideration 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)

(a) We are supportive of the proposed approach.

(b) We harbour doubts as to whether the proposed approach is rigorous enough. We believe that there would be merit in extending the proposed prohibition for loans and guarantees to cover those between the non-network CA firm and an intermediate holding entity or any other related entities of the group audit client.

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

Refer to Q4 comments.

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

We agree with the specific proposals in Section 405 regarding financial interest in the group audit client as well as loans and guarantees. We are especially appreciative of the strict prohibition on component auditors from holding a financial interest in the group audit client irrespective of materiality of the financial interest in or in common with the group audit client.

We also agree with the prohibition of component auditors having loans and guarantees with the group audit client as this can compromise independence.

26. Institut der Wirtschaftsprüfer (Germany) (IDW)

We note that para. 58 of the explanatory memorandum notes that "…there was a practical concern about potentially restricting the pool of non-network firms that could act as CA firms, leading to increased audit market concentration and potential adverse consequences for audit quality."

We agree that for loans and guarantees between the non-network component auditor firm and an intermediate holding entity or any other related entities of the group audit client the CF provides a robust, principles-based approach to identify, evaluate and address any threats that might be created.

27. Institute of Singapore Chartered Accountants (ISCA)

28. Japanese Institute of Certified Public Accountants (JICPA)

We agree with the specific proposals in Section 405 regarding (a) and (b).

29. Korean Institute of Certified Public Accountants (KICPA)

The financial interest described above may have impact on the objectivity of CA even when the CA is outside the network of GA firm. Thus, we agree with the need for requirement to restrict specific interest relationships with GA at the least, as described in the above.

30. Malaysian Institute of Accountants (MIA)

We agree that the possible threats created by financial interest in the group audit client and loans and guarantees should specifically be considered. However, how this will be practically implemented and monitored is not clear.

In addition, we are of the opinion that item (b) of paragraph R405.6 may not be clear as to whether a non-network component auditor firm who does not hold a direct interest but has an indirect financial interest will be required to dispose of these financial interests. It appears that a direct interest is outright prohibited but not indirect interest unless it is "material". Better clarity is needed on the reason for the distinction.

From a practical point of view, we would encourage the IESBA to provide practical guidance on how group auditor firms monitor financial interests and loans and guarantees held by component auditor firms outside the group auditor firm's network in the group audit client.

31. Royal Nederlandse Beroepsorganisatie van Accountants (NBA)

32. New York State Society of CPAs (NYSSCPA)

33. South African Institute of Chartered Accountants (SAICA)

We agree with the proposals in Section 405 regarding financial interest in the group audit client and loans and guarantees. To further clarify the proposals, our view is that examples should be provided in the Application material or through a non-authoritative guidance document explaining the difference between material and immaterial indirect financial interest. Component audit firms as businesses and to ensure the continuity of their operations may have some level of financial interest in some of the entities that they audit. The guidance should be over and above the current guidance that currently exists which is primarily focused on individuals.

34. South African Institute of Professional Accountants (SAIPA)

The IESBA is proposing to introduce an explicit prohibition on non-network CA firms from holding a direct or material indirect financial interest in the entity on whose group financial statements the GA firm expresses an opinion on. We agree with the specific proposals in Section 405 regarding financial interest in the group audit client.

The IESBA came to the view that loans and guarantees are a further area that should be specifically addressed in the proposed Section 405 (beyond the general application of the CF) because of the financial nature of those relationships. We agree with the specific proposals in Section 405 regarding loans and guarantees.

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

We agree.

36. Federation of Accounting Professions, Thailand (TFAC)

Yes, we agree.

37. Wirtschaftsprüferkammer (Germany) (WPK)

We please the IESBA to provide additional application material regarding the calculation of materiality for purposes of a direct financial interest in an entity (similar to R511.3A1 related to the calculation of loans and guarantees).

Firms

38. Association of Italian Audit Firms (ASSIREVI)

We partially agree with the requirements in Section 405 concerning non-network CA firms. In particular:

i. We agree with the provisions of **R405.6 (a)**.

ii. We agree with the requirements in **R405.6 (b)** to the extent that the Code clearly identify the "*entity on whose group financial statements the group auditor firm expresses an opinion*" as the entity itself, without including any related entity. Extending the perimeter to related entities would result in additional complexities and restrictions. The unintended consequences may lead to creating excessive and onerous obligations for the CA, with the potential to reduce the number of available auditors and increase costs for the companies. While the explanatory memorandum does include an explanation and a graphical example that seems to exclude the related entities from the requirements set forth in R405.6 (b), we believe that the public interest should be better served by making this clearer and including it into the definitions.

iii. **R405.6 (c):** In this respect, we urge the IESBA to clearly define the term "*entity on whose group financial statements the group auditor firm expresses an opinion*" by stating that it does not include the related entities and only refer to such entity.

iv. We believe that the requirements in **R405.7 and R405.8** should be clarified in order to explain what the expression "*knows, or has reason to believe*" means in terms of monitoring processes and, in general, internal systems of quality control. In our view, the implementation of specific processes to proactively identify and monitor the relevant relationships or circumstances involving the group audit client at the level of the component auditor firm outside the group auditor firm's network may cause the issues and unintended consequences explained above, with all the potential negative impacts described in the explanatory memorandum.

v. We believe that the provisions in **R405.10** should be clarified, stating that the requirements do not imply that, if the group audit client is a listed entity, the component auditor firm outside the group auditor firm's network should be independent from the related entities of the group audit client or of the component audit client.

As outlined in the explanatory memorandum (see pag. 18), we believe that requiring the component auditor firm outside the group auditor firm's network to be independent also of the related entities would result in "*unintended consequences in going down a prescriptive path of prohibitions*" that may potentially restrict "*the pool of non-network firms that could act as CA firms, leading to increased audit market concentration*" (see previous paragraphs).

In this respect, we urge the IESBA to clearly define the term "*entity on whose group financial statements the group auditor firm expresses an opinion*" by stating that it does not include the related entities and only refer to such entity.

39. BDO International Limited (BDO)

BDO agrees that the possible threats created by financial interest in the group audit client and loans & guarantees should specifically be considered, however how this will be practically implemented and monitored is not clear.

From a practical point of view, BDO encourages the IESBA to provide guidance on 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.

40. Deloitte Touche Tohmatsu Limited (DTTL)

Deloitte Global agrees with the explicit restriction on non-network CA firms having a financial interest in the entity on whose group financial statements the group auditor expresses an opinion, irrespective of materiality of the component to the group audit client. We also agree with the Board's view that the restriction should not be extended to other entities in the group such as an intermediate holding company. However, we do not see a need for the specific reference to the applicable paragraphs on loans and guarantees in paragraph R405.6(c) and believe the restrictions are already sufficiently addressed under the requirements to apply the conceptual framework in R405.7 and R405.8

41. Grant Thornton International Ltd (GTIL)

As it pertains to non-network component audit firms, GTIL agrees with the proposals in Section 405 regarding financial interest in the group audit client and loans and guarantees.

42. Ernst & Young Global Limited (EY)

We agree with the specific proposals in Section 405 regarding financial interests in, and loans and guarantees with, the group audit client. We believe an illustrative chart would provide additional clarity and assist the PA in complying with these provisions.

43. KPMG IFRG Limited (KPMG)

We agree with these independence requirements applicable to the non-network component auditor firm in relation to the component audit client and the entity on whose group financial statements the group auditor firm expresses an opinion. However, we see a need for additional clarification in situations where a group has multiple sub-groups, as the wording in paragraph R405.6 does not effectively exclude sub-groups, even though our understanding is that it is the intent of the Board to exclude such. ISA 600 makes it clear that the sub-group auditor is the "group auditor" for that sub-group. Thus, the phrase "on whose group financial statements the group auditor firm expresses an opinion" needs to be clarified to clearly relate to the ultimate parent group auditor (or at least the top company in the group to prepare group financial statements).

In addition, clarification is needed as to whether an individual from a non-network component auditor firm who reports to a sub-group auditor would need to be independent of that sub-group audit client and its related entities, as well as the ultimate parent group audit client and its related entities.

44. Mazars Group (MAZARS)

45. MNP LLP (MNP)

46. PKF International Limited (PKF)

We agree with the specific proposals in Section 405 regarding (a) and (b) above.

47. Pitcher Partners (PP)

48. PricewaterhouseCoopers International Limited (PWC)

We agree with the proposal to introduce an explicit prohibition on non-network component auditor firms from holding a direct or material indirect financial interest in the entity on whose group financial statements the group auditor firm expresses an opinion and that there should be no materiality consideration in this regard.

We also agree with the decision taken to also only restrict non-network component auditor firms from having loans and guarantees with the group audit entity. In the case of both financial interests and loans and guarantees, there is clearly a public interest cost/benefit judgement as to whether these provisions should also be applied to intermediate holding entities and related entities. We believe it is important that the same principle be applied to both financial interests and loans and guarantees. Based on the explanation of the IESBAs considerations on this matter (which will require the application of the conceptual framework in relation to other relevant interests and loans), we support the proposed decision to apply the restrictions only in relation to the group audit entity.

Others

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

Related to loans and guarantees, R511.3A1 states that “this section contains references to the “materiality” of a loan or guarantee. In determining whether such a loan or guarantee is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.” The SMPAG did not see where calculating materiality for purposes of a direct financial interest in an entity is provided, so additional application material similar to what is already in the Code related to loans and guarantees would be helpful to assist Professional Accountants (PAs) in performing this assessment.