

Agenda Item 1-B.3

Sustainability – Drafting Option 3 (MARK-UP FROM EXTANT)

Option 3 – Builds on existing drafting convention, but with use of a general term “engagement” to cover “audit, review and sustainability assurance engagements”. Approach also uses other more general terms (e.g., “practitioner”). *(Proposed ET-GA revisions not yet considered.)*

Note to Meeting Participants

This document includes proposed revisions to extracts of Part 4A (i.e., extant Section 400, updated for the PIE revisions¹ that come into effect at the end of 2024). It is provided for information purposes and is intended to assist in determining the approach to be used in drafting independence provisions for Sustainability Assurance Engagements.

The sustainability-related revisions will be made to the most up-to-date version of the Code and will incorporate IESBA-approved revisions as of December 2022. This will include the revised PIE definition and the soon to be finalized ET-GA revisions.² The ED will also incorporate the technology-related revisions provided that they are finalized by March 2023.

INTERNATIONAL INDEPENDENCE STANDARDS (PARTS 4A AND 4B)

PART 4A – INDEPENDENCE FOR AUDIT, ~~AND REVIEW~~ AND SUSTAINABILITY ENGAGEMENTS

SECTION 400

APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

Introduction

General

400.1 It is in the public interest and required by the Code that professional accountants in public practice be independent when performing audit or review engagements. It is also in the public interest that practitioners performing sustainability assurance engagements [to provide assurance on sustainability information designed to meet the common needs of a wide range of users] be independent.

400.2 This Part applies to ~~both audit, and review~~ and sustainability assurance engagements (“engagements”) unless otherwise stated. ~~The terms “audit,” “audit team,” “audit~~

Commented [KB1]: Need to define. E.g. An assurance engagement conducted in accordance with International Standards on Sustainability Assurance or equivalent.

Commented [KB2]: Exclude if covered by the definition of a ‘sustainability assurance engagement’; or in due course align with how IAASB decides to describe the scope of its ISSAs.

¹ The revised PIE definition related revisions are shaded in yellow and will become effective for audits of financial statements for periods beginning on or after December 15, 2024

² The September 2022 draft of the ET-GA revisions are shaded in turquoise and are subject to change.

engagement,” “audit client,” and “audit report” apply equally to review, review team, review engagement, review client, and review engagement report. —

400.3 In this Part, the term “~~professional accountant~~” “~~practitioner~~” refers to individual “professional accountants” in public practice, ~~other individuals conducting sustainability assurance engagements~~, and their firms.

400.4 ~~ISQM 1~~ requires a firm to design implement and operate a system of quality management for audits or reviews of financial statements, ~~or other assurance or related services engagements~~ performed by the firm. As part of this system of quality management, ISQM 1 requires the firm to establish quality objectives that address the fulfilment of responsibilities in accordance with relevant ethical requirements, including those related to independence. Under ISQM 1, relevant ethical requirements are those related to the firm, its personnel and, when applicable, others subject to the independence requirements to which the firm and the firm’s engagements are subject. ISAs, ~~and~~ ISREs ~~and~~ ISSAs establish responsibilities for engagement partners / ~~leaders~~ and engagement teams at the level of the engagement for audits, ~~and~~ reviews ~~and~~ sustainability assurance engagements, respectively. The allocation of responsibilities within a firm will depend on its size, structure and organization. Many of the provisions of this Part do not prescribe the specific responsibility of individuals within the firm for actions related to independence, instead referring to “firm” for ease of reference. A firm assigns operational responsibility for compliance with independence requirements to an individual(s) in accordance with ISQM 1. In addition, an individual ~~professional accountant-practitioner~~ remains responsible for compliance with any provisions that apply to that ~~accountant’s practitioner’s~~ activities, interests or relationships.

Commented [KB3]: Align in due course with IAASB position on ISQM 1 when known.

Commented [KB4]: Align in due course with IAASB position when known.

400.5 Independence is linked to the principles of objectivity and integrity. It comprises:

- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm’s, or an audit team member’s, integrity, objectivity or professional skepticism has been compromised.

In this Part, references to an individual or firm being “independent” mean that the individual or firm has complied with the provisions of this Part.

400.6 When performing ~~audit~~ engagements, the Code requires firms to comply with the fundamental principles and be independent. This Part sets out specific requirements and application material on how to apply the conceptual framework to maintain independence when performing such engagements. The conceptual framework set out in Section 120 applies to independence as it does to the fundamental principles set out in Section 110.

400.7 This Part describes:

- (a) Facts and circumstances, including professional activities, interests and relationships, that create or might create threats to independence;
- (b) Potential actions, including safeguards, that might be appropriate to address any such threats; and
- (c) Some situations where the threats cannot be eliminated or there can be no

safeguards to reduce them to an acceptable level.

Public Interest Entities

400.8 Some of the requirements and application material set out in this Part are applicable only to ~~the audit of financial statements engagements of~~ public interest entities, reflecting significant public interest in the financial condition and sustainability related factors of these entities due to the potential impact of their financial well-being and approach to sustainability on stakeholders.

400.9 Factors to consider in evaluating the extent of public interest in the financial condition of an entity include:

- The nature of the business or activities, such as taking on financial obligations to the public as part of the entity's primary business.
- Whether the entity is subject to regulatory supervision designed to provide confidence that the entity will meet its financial obligations.
- Size of the entity.
- The importance of the entity to the sector in which it operates including how easily replaceable it is in the event of financial failure.
- Number and nature of stakeholders including investors, customers, creditors and employees.
- The potential systemic impact on other sectors and the economy as a whole in the event of financial failure of the entity.

Factors to consider in evaluating the extent of public interest in the sustainability related factors of an entity include:

•

Commented [KB5]: O/s to include examples.

400.10 Stakeholders have heightened expectations regarding the independence of a firm performing an ~~audit~~ engagement for a public interest entity because of the significance of the public interest in the financial condition and sustainability related factors of the entity. The purpose of the requirements and application material for public interest entities as described in paragraph 400.8 is to meet these expectations, thereby enhancing stakeholders' confidence in the entity's financial statements that can be used when assessing the entity's financial condition.

Reports that Include a Restriction on Use and Distribution

400.11 An audit report might include a restriction on use and distribution. If it does and the conditions set out in Section 800 are met, then the independence requirements in this Part may be modified as provided in Section 800.

Commented [KB6]: This could also apply in theory to sustainability assurance engagements but might be unlikely?

Assurance Engagements other than Audit and Review Engagements

400.12 Independence standards for assurance engagements that are not audit, ~~or~~ review or sustainability assurance engagements are set out in Part 4B – *Independence for Assurance Engagements Other than Audit, ~~and~~ Review and Sustainability Assurance Engagements*.

Requirements and Application Material

General

- R400.13** A firm performing an audit-engagement shall be independent.
- R400.14** A firm shall apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence in relation to an audit-engagement.

Prohibition on Assuming Management Responsibilities

- R400.15** A firm or a network firm shall not assume a management responsibility for an audit-engagement client.
- 400.15 A1 Management responsibilities involve controlling, leading and directing an entity, including making decisions regarding the acquisition, deployment and control of human, financial, technological, physical and intangible resources.
- 400.15 A2 When a firm or a network firm assumes a management responsibility for an audit-engagement client, self-review, self-interest and familiarity threats are created. Assuming a management responsibility might also create an advocacy threat because the firm or network firm becomes too closely aligned with the views and interests of management.
- 400.15 A3 Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgment. Examples of activities that would be considered a management responsibility include:
- Setting policies and strategic direction.
 - Hiring or dismissing employees.
 - Directing and taking responsibility for the actions of employees in relation to the employees' work for the entity.
 - Authorizing transactions.
 - Controlling or managing bank accounts or investments.
 - Deciding which recommendations of the firm or network firm or other third parties to implement.
 - Reporting to those charged with governance on behalf of management.
 - Taking responsibility for:
 - The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
 - The preparation and fair presentation of the sustainability related information in accordance with the applicable sustainability reporting framework
 - Designing, implementing, monitoring or maintaining internal control.
- 400.15 A4 Subject to compliance with paragraph R400.14, providing advice and recommendations to assist the management of an audit-engagement client in discharging its responsibilities is not assuming a management responsibility. The provision of advice and recommendations to an audit client might create a self-review threat and is addressed in Section 600.
- R400.16** When performing a professional activity for an audit-engagement client, the firm shall be satisfied that client management makes all judgments and decisions that are the proper responsibility of management. This includes ensuring that the client's management:

- (a) Designates an individual who possesses suitable skill, knowledge and experience to be responsible at all times for the client's decisions and to oversee the activities. Such an individual, preferably within senior management, would understand:
 - (i) The objectives, nature and results of the activities; and
 - (ii) The respective client and firm or network firm responsibilities.
 However, the individual is not required to possess the expertise to perform or re-perform the activities.
- (b) Provides oversight of the activities and evaluates the adequacy of the results of the activities performed for the client's purpose.
- (c) Accepts responsibility for the actions, if any, to be taken arising from the results of the activities.

Public Interest Entities

R400.17 For the purposes of this Part, a firm shall treat an entity as a public interest entity when it falls within any of the following categories:

- (a) A publicly traded entity;
- (b) An entity one of whose main functions is to take deposits from the public;
- (c) An entity one of whose main functions is to provide insurance to the public; or
- (d) An entity specified as such by law, regulation or professional standards to meet the purpose described in paragraph 400.10.

400.17 A1 When terms other than public interest entity are applied to entities by law, regulation or professional standards to meet the purpose described in paragraph 400.10, such terms are regarded as equivalent terms. However, if law, regulation or professional standards designate entities as "public interest entities" for reasons unrelated to the purpose described in paragraph 400.10, that designation does not necessarily mean that such entities are public interest entities for the purposes of the Code.

R400.18 In complying with the requirement in paragraph R400.17, a firm shall take into account more explicit definitions established by law, regulation or professional standards for the categories set out in paragraph R400.17 (a) to (c).

400.18 A1 The categories set out in paragraph R400.17 (a) to (c) are broadly defined and no recognition is given to any size or other factors that can be relevant in a specific jurisdiction. The Code therefore provides for those bodies responsible for setting ethics standards for professional accountants to more explicitly define these categories by, for example:

- Making reference to specific public markets for trading securities.
- Making reference to the local law or regulation defining banks or insurance companies.
- Incorporating exemptions for specific types of entities, such as an entity with mutual ownership.
- Setting size criteria for certain types of entities.

400.18 A2 Paragraph R400.17 (d) anticipates that those bodies responsible for setting ethics standards for professional accountants will add categories of public interest entities to meet the

purpose described in paragraph 400.10, taking into account factors such as those set out in paragraph 400.9. Depending on the facts and circumstances in a specific jurisdiction, such categories could include:

- Pension funds.
- Collective investment vehicles.
- Private entities with large numbers of stakeholders (other than investors).
- Not-for-profit organizations or governmental entities.
- Public utilities.

400.19 A1

A firm is encouraged to determine whether to treat other entities as public interest entities for the purposes of this Part. When making this determination, the firm might consider the factors set out in paragraph 400.9 as well as the following factors:

- Whether the entity is likely to become a public interest entity in the near future.
- Whether in similar circumstances, a predecessor firm has applied independence requirements for public interest entities to the entity.
- Whether in similar circumstances, the firm has applied independence requirements for public interest entities to other entities.
- Whether the entity has been specified as not being a public interest entity by law, regulation or professional standards.
- Whether the entity or other stakeholders requested the firm to apply independence requirements for public interest entities to the entity and, if so, whether there are any reasons for not meeting this request.
- The entity's corporate governance arrangements, for example, whether those charged with governance are distinct from the owners or management.

Public Disclosure – Application of Independence Requirements for Public Interest Entities

R400.20

Subject to paragraph R400.21, when a firm has applied the independence requirements for public interest entities as described in paragraph 400.8 in performing an audit of the financial statements of engagement for an entity, the firm shall publicly disclose that fact in a manner deemed appropriate, taking into account the timing and accessibility of the information to stakeholders.

R400.21

As an exception to paragraph R400.20, a firm may not make such a disclosure if doing so will result in disclosing confidential future plans of the entity.

Related Entities

R400.22

As defined, an audit engagement client that is a publicly traded entity in accordance with paragraphs R400.17 and R400.18 includes all of its related entities. For all other entities, references to an audit engagement client in this Part include related entities over which the client has direct or indirect control. When the audit engagement team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit engagement team shall include that related entity when identifying, evaluating and addressing threats to independence.

[Paragraphs 400.23 to 400.29 are intentionally left blank]

Period During which Independence is Required

R400.30 Independence, as required by this Part, shall be maintained during both:

- (a) The engagement period; and
- (b) In the case of an audit or review engagement, the period covered by the financial statements; or
- (c) In the case of a sustainability assurance engagement, throughout any period over which, or from the time at which the sustainability related information is measured or evaluated in connection with the engagement and throughout any subsequent period until the engagement has been completed.

Commented [KB7]: Need to consider what an appropriate period for sustainability related information would be. This is just a first thought suggestion .

400.30 A1 The engagement period starts when the audit-engagement team begins to perform the audit-engagement. The engagement period ends when the audit-engagement report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has ended or the issuance of the final audit-engagement report.

R400.31 If an entity becomes an audit-engagement client during or after the period covered by the financial statements or sustainability related information on which the firm will express an opinion, the firm shall determine whether any threats to independence are created by:

- (a) Financial or business relationships with the audit-engagement client during or after the period covered by the financial statements or sustainability related information but before accepting the audit-engagement; or
- (b) Services provided to the audit-engagement client by the firm or a network firm in prior financial statement periods or, in relation to sustainability related information, services provided prior to the period described in R400.30 (c).

400.31 A1 Threats to independence are created if a non-assurance service was provided to an audit-engagement client during, or after the period covered by the financial statements or the period described in R300.30 (c) for sustainability related information, but before the audit-engagement team begins to perform the audit-engagement, and the service would not be permitted during the engagement period.

400.31 A2 A factor to be considered in such circumstances is whether the results of the service provided might form part of or affect the accounting records, the data records underlying the sustainability related information, the internal controls over financial or sustainability reporting, or the financial statements or sustainability related information on which the firm will express an opinion.

400.31 A3 Examples of actions that might be safeguards to address threats independence include:

- Not assigning professionals who performed the non-assurance service to be members of the engagement team.
- Having an appropriate reviewer review the audit-engagement work or non-assurance service as appropriate.
- Engaging another firm outside of the network to evaluate the results of the non-assurance service or having another firm outside of the network re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

400.31 A4 A threat to independence created by the provision of a non-assurance service by a firm or

a network firm prior to the ~~audit~~-engagement period or prior to the period covered by the financial statements or sustainability related information on which the firm will express an opinion is eliminated or reduced to an acceptable level if the results of such service have been used or implemented in a period ~~audited for which an engagement has been performed~~ by another firm.

Audit-Engagement Clients that are Public Interest Entities

R400.32 A firm shall not accept appointment ~~as auditor of to undertake an engagement for~~ a public interest entity to which the firm or the network firm has provided a non-assurance service prior to such appointment that might create a self-review threat in relation to the financial statements or sustainability related information on which the firm will express an opinion unless:

- (a) The provision of such service ceases before the commencement of the ~~audit~~ engagement period;
- (b) The firm takes action to address any threats to its independence; and
- (c) The firm determines that, in the view of a reasonable and informed third party, any threats to the firm's independence have been or will be eliminated or reduced to an acceptable level.

400.32 A1 Actions that might be regarded by a reasonable and informed third party as eliminating or reducing to an acceptable level any threats to independence created by the provision of non-assurance services to a public interest entity prior to appointment ~~as auditor of to undertake an engagement for~~ that entity include:

- The results of the service had been subject to auditing procedures in the course of the ~~audit of engagement for~~ the prior year's financial statements or sustainability related information by a predecessor firm.
- The firm engages a professional accountant or practitioner, who is not a member of the firm expressing the opinion on the financial statements or sustainability related information, to perform a review of the first ~~audit~~-engagement affected by the self-review threat consistent with the objective of an engagement quality review.
- The public interest entity engages another firm outside of the network to:
 - (i) Evaluate the results of the non-assurance service; or
 - (ii) Re-perform the service,to the extent necessary to enable the other firm to take responsibility for the result of the service.

[Paragraphs 400.33 to 400.39 are intentionally left blank]

Communication with those Charged with Governance

400.40 A1 Paragraphs R300.9 and R300.10 set out requirements with respect to communicating with those charged with governance.

400.40 A2 Even when not required by the Code, applicable professional standards, laws or regulations, regular communication is encouraged between a firm and those charged with governance of the client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication enables those charged

with governance to:

- (a) Consider the firm's judgments in identifying and evaluating threats;
- (b) Consider how threats have been addressed including the appropriateness of safeguards when they are available and capable of being applied; and
- (c) Take appropriate action.

Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

[Paragraphs 400.41 to 400.49 are intentionally left blank]

Network Firms

400.50 A1 Firms frequently form larger structures with other firms and entities to enhance their ability to provide professional services. Whether these larger structures create a network depends on the particular facts and circumstances. It does not depend on whether the firms and entities are legally separate and distinct.

R400.51 A network firm shall be independent of the audit engagement clients of the other firms within the network as required by this Part.

400.51 A1 The independence requirements in this Part that apply to a network firm apply to any entity that meets the definition of a network firm. It is not necessary for the entity also to meet the definition of a firm. For example, a consulting practice or professional law practice might be a network firm but not a firm.

R400.52 When associated with a larger structure of other firms and entities, a firm shall:

- (a) Exercise professional judgment to determine whether a network is created by such a larger structure;
- (b) Consider whether a reasonable and informed third party would be likely to conclude that the other firms and entities in the larger structure are associated in such a way that a network exists; and
- (c) Apply such judgment consistently throughout such a larger structure.

R400.53 When determining whether a network is created by a larger structure of firms and other entities, a firm shall conclude that a network exists when such a larger structure is aimed at co-operation and:

- (a) It is clearly aimed at profit or cost sharing among the entities within the structure. (Ref: Para. 400.53 A2);
- (b) The entities within the structure share common ownership, control or management. (Ref: Para. 400.53 A3);
- (c) The entities within the structure share common quality management policies and procedures. (Ref: Para. 400.53 A4);
- (d) The entities within the structure share a common business strategy. (Ref: Para. 400.53 A5);
- (e) The entities within the structure share the use of a common brand name. (Ref: Para. 400.53 A6, 400.53 A7); or
- (f) The entities within the structure share a significant part of professional resources.

Commented [KB8]: The definition would also work for firms providing sustainability assurance services that are not firms of professional accountants.

It is important to retain this concept for non-accountancy firms providing sustainability assurance services. As the market matures it is possible that networks of such firms could further develop.

Also, ISQM 1 has requirements applicable to networks.

(Ref: Para 400.53 A8, 400.53 A9).

- 400.53 A1 There might be other arrangements between firms and entities within a larger structure that constitute a network, in addition to those arrangements described in paragraph R400.53. However, a larger structure might be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network.
- 400.53 A2 The sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of ~~audit~~ engagement methodologies, manuals or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity jointly to provide a service or develop a product does not in itself create a network. (Ref: Para. R400.53(a)).
- 400.53 A3 Common ownership, control or management might be achieved by contract or other means. (Ref: Para. R400.53(b)).
- 400.53 A4 Common quality management policies and procedures are those designed, implemented and operated across the larger structure. (Ref: Para. R400.53(c)).
- 400.53 A5 Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service. (Ref: Para. R400.53(d)).
- 400.53 A6 A common brand name includes common initials or a common name. A firm is using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name when a partner of the firm signs an audit report. (Ref: Para. R400.53(e)).
- 400.53 A7 Even if a firm does not belong to a network and does not use a common brand name as part of its firm name, it might appear to belong to a network if its stationery or promotional materials refer to the firm being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such membership, a perception might be created that the firm belongs to a network. (Ref: Para. R400.53(e)).
- 400.53 A8 Professional resources include:
- Common systems that enable firms to exchange information such as client data, billing and time records.
 - Partners and other personnel.
 - Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements.
 - ~~Audit-Engagement~~ methodology or ~~audit-engagement~~ manuals.
 - Training courses and facilities. (Ref: Para. R400.53(f)).
- 400.53 A9 Whether the shared professional resources are significant depends on the circumstances. For example:
- The shared resources might be limited to common ~~audit-engagement~~ methodology or ~~audit-engagement~~ manuals, with no exchange of personnel or client or market information. In such circumstances, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor.
 - The shared resources might involve the exchange of personnel or information, such

as where personnel are drawn from a shared pool, or where a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow. In such circumstances, a reasonable and informed third party is more likely to conclude that the shared resources are significant. (Ref: Para. R400.53(f)).

R400.54 If a firm or a network sells a component of its practice, and the component continues to use all or part of the firm's or network's name for a limited time, the relevant entities shall determine how to disclose that they are not network firms when presenting themselves to outside parties.

400.54 A1 The agreement for the sale of a component of a practice might provide that, for a limited period of time, the sold component can continue to use all or part of the name of the firm or the network, even though it is no longer connected to the firm or the network. In such circumstances, while the two entities might be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at cooperation. The two entities are therefore not network firms.

[Paragraphs 400.55 to 400.59 are intentionally left blank]

General Documentation of Independence for Audit and Review Engagements

R400.60 A firm shall document conclusions regarding compliance with this Part, and the substance of any relevant discussions that support those conclusions. In particular:

- (a) When safeguards are applied to address a threat, the firm shall document the nature of the threat and the safeguards in place or applied; and
- (b) When a threat required significant analysis and the firm concluded that the threat was already at an acceptable level, the firm shall document the nature of the threat and the rationale for the conclusion.

400.60 A1 Documentation provides evidence of the firm's judgments in forming conclusions regarding compliance with this Part. However, a lack of documentation does not determine whether a firm considered a particular matter or whether the firm is independent.

[Paragraphs 400.61 to 400.69 are intentionally left blank]

Mergers and Acquisitions

When a Client Merger Creates a Threat

400.70 A1 An entity might become a related entity of an **audit engagement** client because of a merger or acquisition. A threat to independence and, therefore, to the ability of a firm to continue an **audit engagement** might be created by previous or current interests or relationships between a firm or network firm and such a related entity.

R400.71 In the circumstances set out in paragraph 400.70 A1,

- (a) The firm shall identify and evaluate previous and current interests and relationships with the related entity that, taking into account any actions taken to address the threat, might affect its independence and therefore its ability to continue the **audit engagement** after the effective date of the merger or acquisition; and
- (b) Subject to paragraph R400.72, the firm shall take steps to end any interests or relationships that are not permitted by the Code by the effective date of the merger

or acquisition.

R400.72 As an exception to paragraph R400.71(b), if the interest or relationship cannot reasonably be ended by the effective date of the merger or acquisition, the firm shall:

- (a) Evaluate the threat that is created by the interest or relationship; and
- (b) Discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be ended by the effective date and the evaluation of the level of the threat.

400.72 A1 In some circumstances, it might not be reasonably possible to end an interest or relationship creating a threat by the effective date of the merger or acquisition. This might be because the firm provides a non-assurance service to the related entity, which the entity is not able to transition in an orderly manner to another provider by that date.

400.72 A2 Factors that are relevant in evaluating the level of a threat created by mergers and acquisitions when there are interests and relationships that cannot reasonably be ended include:

- The nature and significance of the interest or relationship.
- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent).
- The length of time until the interest or relationship can reasonably be ended.

R400.73 If, following the discussion set out in paragraph R400.72(b), those charged with governance request the firm to continue as the auditor undertaking an engagement, the firm shall do so only if:

- (a) The interest or relationship will be ended as soon as reasonably possible but no later than six months after the effective date of the merger or acquisition;
- (b) Any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted by Section 600 and its subsections, will not be a member of the engagement team for the audit engagement or the individual responsible for the engagement quality review; and
- (c) Transitional measures will be applied, as necessary, and discussed with those charged with governance.

400.73 A1 Examples of such transitional measures include:

- Having a professional accountant or practitioner review the audit engagement or non-assurance work as appropriate.
- Having a professional accountant or practitioner, who is not a member of the firm expressing the opinion on the financial statements or sustainability related information, perform a review that is consistent with the objective of an engagement quality review.
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

R400.74 The firm might have completed a significant amount of work on the audit engagement prior to the effective date of the merger or acquisition and might be able to complete the remaining audit engagement procedures within a short period of time. In such

circumstances, if those charged with governance request the firm to complete the audit engagement while continuing with an interest or relationship identified in paragraph 400.70 A1, the firm shall only do so if it:

- (a) Has evaluated the level of the threat and discussed the results with those charged with governance;
- (b) Complies with the requirements of paragraph R400.73(b) to (c); and
- (c) Ceases to be the auditor-engagement performer no later than the date that the audit engagement report is issued.

If Objectivity Remains Compromised

R400.75 Even if all the requirements of paragraphs R400.71 to R400.74 could be met, the firm shall determine whether the circumstances identified in paragraph 400.70 A1 create a threat that cannot be addressed such that objectivity would be compromised. If so, the firm shall cease to be the auditor undertake the engagement.

Documentation

R400.76 The firm shall document:

- (a) Any interests or relationships identified in paragraph 400.70 A1 that will not be ended by the effective date of the merger or acquisition and the reasons why they will not be ended;
- (b) The transitional measures applied;
- (c) The results of the discussion with those charged with governance; and
- (d) The reasons why the previous and current interests and relationships do not create a threat such that objectivity would be compromised.

[Paragraphs 400.77 to 400.79 are intentionally left blank.]

Breach of an Independence Provision for Audit and Review Engagements

When a Firm Identifies a Breach

R400.80 If a firm concludes that a breach of a requirement in this Part has occurred, the firm shall:

- (a) End, suspend or eliminate the interest or relationship that created the breach and address the consequences of the breach;
- (b) Consider whether any legal or regulatory requirements apply to the breach and, if so:
 - (i) Comply with those requirements; and
 - (ii) Consider reporting the breach to a professional or regulatory body or oversight authority if such reporting is common practice or expected in the relevant jurisdiction;
- (c) Promptly communicate the breach in accordance with its policies and procedures to:
 - (i) The engagement partner / leader;
 - (ii) The individual with operational responsibility for compliance with independence requirements;

- (iii) Other relevant personnel in the firm and, where appropriate, the network; and
- (iv) Those subject to the independence requirements in Part 4A who need to take appropriate action;
- (d) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an audit report; and
- (e) Depending on the significance of the breach, determine:
 - (i) Whether to end the audit-engagement; or
 - (ii) Whether it is possible to take action that satisfactorily addresses the consequences of the breach and whether such action can be taken and is appropriate in the circumstances.

In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party would be likely to conclude that the firm's objectivity would be compromised, and therefore, the firm would be unable to issue an audit-engagement report.

400.80 A1 A breach of a provision of this Part might occur despite the firm having a system of quality management designed to address independence requirements. It might be necessary to end the audit-engagement because of the breach.

400.80 A2 The significance and impact of a breach on the firm's objectivity and ability to issue an audit-engagement report will depend on factors such as:

- The nature and duration of the breach.
- The number and nature of any previous breaches with respect to the current audit engagement.
- Whether an audit-engagement team member had knowledge of the interest or relationship that created the breach.
- Whether the individual who created the breach is an audit-engagement team member or another individual for whom there are independence requirements.
- If the breach relates to an audit-engagement team member, the role of that individual.
- If the breach was created by providing a professional service, the impact of that service, if any, on the accounting records or the amounts recorded in the financial statements, or on the sustainability related information, on which the firm will express an opinion.
- The extent of the self-interest, advocacy, intimidation or other threats created by the breach.

400.80 A3 Depending upon the significance of the breach, examples of actions that the firm might consider to address the breach satisfactorily include:

- Removing the relevant individual from the audit-engagement team.
- Using different individuals to conduct an additional review of the affected audit engagement work or to re-perform that work to the extent necessary.
- Recommending that the audit-engagement client engage another firm to review or

re-perform the affected audit engagement work to the extent necessary.

- If the breach relates to a non-assurance service that affects the accounting records or an amount recorded in the financial statements, or the sustainability related information, engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

R400.81 If the firm determines that action cannot be taken to address the consequences of the breach satisfactorily, the firm shall inform those charged with governance as soon as possible and take the steps necessary to end the audit engagement in compliance with any applicable legal or regulatory requirements. Where ending the engagement is not permitted by laws or regulations, the firm shall comply with any reporting or disclosure requirements.

R400.82 If the firm determines that action can be taken to address the consequences of the breach satisfactorily, the firm shall discuss with those charged with governance:

- (a) The significance of the breach, including its nature and duration;
- (b) How the breach occurred and how it was identified;
- (c) The action proposed or taken and why the action will satisfactorily address the consequences of the breach and enable the firm to issue an audit report;
- (d) The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion; and
- (e) Any steps proposed or taken by the firm to reduce or avoid the risk of further breaches occurring.

Such discussion shall take place as soon as possible unless an alternative timing is specified by those charged with governance for reporting less significant breaches.

Communication of Breaches to Those Charged with Governance

400.83 A1 Paragraphs R300.9 and R300.10 set out requirements with respect to communicating with those charged with governance.

R400.84 With respect to breaches, the firm shall communicate in writing to those charged with governance:

- (a) All matters discussed in accordance with paragraph R400.82 and obtain the concurrence of those charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach; and
- (b) A description of:
 - (i) The firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained; and
 - (ii) Any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring.

R400.85 If those charged with governance do not concur that the action proposed by the firm in accordance with paragraph R400.80(e)(ii) satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to end the audit engagement in accordance with paragraph R400.81.

Breaches Before the Previous Audit Report Was Issued

R400.86 If the breach occurred prior to the issuance of the previous audit engagement report, the firm shall comply with the provisions of Part 4A in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit engagement report in the current period.

R400.87 The firm shall also:

- (a) Consider the impact of the breach, if any, on the firm's objectivity in relation to any previously issued audit engagement reports, and the possibility of withdrawing such audit engagement reports; and
- (b) Discuss the matter with those charged with governance.

Documentation

R400.88 In complying with the requirements in paragraphs R400.80 to R400.87, the firm shall document:

- (a) The breach;
- (b) The actions taken;
- (c) The key decisions made;
- (d) All the matters discussed with those charged with governance; and
- (e) Any discussions with a professional or regulatory body or oversight authority.

R400.89 If the firm continues with the audit engagement, it shall document:

- (a) The conclusion that, in the firm's professional judgment, objectivity has not been compromised; and
- (b) The rationale for why the action taken satisfactorily addressed the consequences of the breach so that the firm could issue an audit engagement report.