

Collective Investment Vehicles, Pension Funds and Investment Company Complexes – Update

I. Executive Summary

1. The objectives of this workstream¹ include gaining a comprehensive understanding of the relationships between collective investment vehicles (CIVs) and pension funds and those entities or persons that act (or provide services) as their trustees, managers, and advisors in order to determine whether the independence provisions, and in particular, the definition of a “related entity” in Part 4A of the Code,² adequately address the independence implications arising from those relationships.
2. The financial risks arising from investment funds vary greatly depending on the investment purpose or strategy, the structure used, and the types of investors involved. CIVs usually consist of pooled resources contributed by members of the general public. Other funds adopt an investment strategy that carries a high degree of uncertainty, such as private equity funds, and are usually accessible only to sophisticated investors.
3. The Project Team has focused on CIVs that are open to the general public, and pension funds³ that have similar characteristics as CIVs as analyzed by the Project Team (hereafter referred to as “Investment Schemes”), because those are the funds where the potential risk to the public is highest.
4. The Code provides that:
 - When performing an audit engagement, firms must comply with the fundamental principles and be independent (paragraph 400.6).
 - To meet these requirements, professional accountants (PAs) are required to apply the conceptual framework, as set out in Section 120, to identify, evaluate and address threats to compliance with the fundamental principles and to independence.
 - Independence is linked to the principles of objectivity and integrity,⁴ both which are essential to minimize the risks of undue influence on the auditor’s professional judgment and professional skepticism, and the obligation to act in the public interest.

The provisions in Part 4A focus the independence analysis on interests, relationships and circumstances that have the potential to pose threats to an auditor’s objectivity and integrity.

5. As these provisions are central to the conceptual underpinning and operation of the Code, the Project Team has:
 - (a) Researched the structures of Investment Schemes in different jurisdictions around the world to understand their relationships with parties such as trustees, managers, and advisors;
 - (b) Identified a fundamental difference between the structure of Investment Schemes and traditional corporate entities – namely that the management (or others that may have significant

¹ Refer paragraph 4 of the [Terms of Reference](#).

² [The International Code of Ethics for Professional Accountants \(including International Independence Standards\) \(Code\)](#).

³ Refer to [paragraph 39](#).

⁴ Paragraph 400.5 of the Code.

influence over information that impacts the financial statements of the Investment Scheme) are generally external to the Scheme;

- (c) Noted that the US Securities and Exchange Commission (SEC) has recognized that the difference between Investment Scheme structures and traditional corporate structures gives rise to a gap that is not addressed by its independence rules for audits of traditional corporate issuers in the US and, given the tremendous growth of the pooled investment industry, has implemented rules and regulations to address that independence gap.

The SEC rules introduced an additional “limb” which applies if the entity under audit is an investment company or investment adviser or sponsor. This additional limb provides that “affiliates” are to be determined in a way that bridges the independence gap that arises when the audit client engages a third party as investment advisor or sponsor.

- (d) Engaged with staff of the International Auditing and Assurance Standards Board (IAASB) to obtain a better understanding of the application of the International Standards on Auditing (ISAs) to Investment Scheme audits. As the ISAs do not specifically address these types of structures, certain auditing principles embedded in the ISAs may be applicable when performing these types of audit engagements.

These matters are considered more fully in [Section II](#) below.

- 6. Against this background, the Project Team has reviewed the extant Code and believes, for the reasons set out in [Section III](#), that:

- (a) Unrelated third parties⁵ that undertake significant management responsibilities on behalf of an Investment Scheme and/or are in a position to exert significant influence⁶ over the financial records or financial statements of that Scheme will not be captured by the Code’s definitions of “audit client” and “related entity” as they do not control or have significant influence over the Scheme (as required by those definitions); and
- (b) In the absence of additional specific provisions in the Code, there is a risk that auditors will not apply the conceptual framework in a consistent manner when they are considering circumstances set out in paragraph 6(a) above.

Refer to [Appendix 1](#) for a flowchart that demonstrates the above.

Accordingly, the Project Team would like to seek the Board’s views on the questions set out in [Section V](#).

⁵ Unrelated third parties can comprise an entity or individual.

⁶ The Code makes various references in Part 4A to individuals in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion, which has a different context and meaning to the use of the term “significant influence” in the definition of related entity in the Code.

II. The Project Team's Outreach and Research

Organizational Structure and Management of Investment Schemes

Jurisdictional Analysis

7. Since December 2023, the Project Team has researched various jurisdictions to better understand the global context of Investment Schemes and their relationships with parties such as trustees, managers, and advisors to develop an in-depth knowledge of the overall Scheme governance and the roles and functions that these parties undertake. Understanding these relationships is fundamental to determining whether the “*related entity*” definition in the Code, which is determined by elements of control or significant influence, adequately addresses these types of audit clients and captures the appropriate parties involved with the Scheme. [Appendix 2](#) lists the stakeholders the Project Team engaged with in 2024, and the jurisdictions they represent.
8. The Project Team's research identified significant governance and structural differences in Investment Schemes compared to traditional corporate structures. Generally, Investment Schemes do not have their own employees. In such cases, the day-to-day operations of the Scheme, and the investment and management of the Scheme investors' funds, are typically undertaken by, or outsourced to a third-party or parties (called various names in different jurisdictions) in accordance with an underlying foundational document or agreement.
9. Aspects of corporate governance normally assumed within an organization, including certain oversight and management functions, are often undertaken externally to the Investment Scheme itself. This is consistent with the IOSCO Technical Committee's definition of governance for collective investment schemes (CISs), which recognizes “*the differences between the nature and purpose of CIS and the operating companies in which they invest*” and “*the fact that CIS are structured and regulated differently.*”⁷
10. This research also underscores that Investment Schemes assume various designs of legal framework and are subject to different jurisdiction-specific legal and regulatory obligations, resulting in diversity regarding which organization(s) is(are) responsible for the Scheme's oversight and management. The Project Team has also identified that it is not unusual for third parties engaged by Schemes to be involved in activities and decisions regarding the acquisition, deployment and control of resources, and/or designing, implementing, monitoring or maintaining internal controls.
11. The Project Team's research further highlighted that Investment Scheme sponsors (called various names in different jurisdictions) might be influential to both the creation and continuing operation of the Scheme. Sponsors generally establish the Scheme, set up founding documents, make sure the Scheme meets legal requirements, and might even inject seed capital.⁸ The sponsor might also be responsible for choosing crucial service providers such as fund managers, custodians, and in some instances the auditors of the Scheme. This does not necessarily mean that the sponsor controls or has significant influence over the Scheme.

⁷ Refer page 3 of the Report of the Technical Committee of the IOSCO [Examination of Governance for Collective Investment Funds Final Report Part I](#).

⁸ In certain jurisdictions, for example India and Singapore, the sponsor is required to invest a specified amount into the scheme to signal its commitment and to build investor confidence.

12. At both the [March 2024](#) and [June 2024](#) IESBA meetings the Project Team highlighted that the scope of the independence provisions in Part 4A of the Code is determined by the definition of “audit client”⁹ and the elements of “control” or “significant influence”, which are fundamental to determining whether an entity is a “related entity”¹⁰ to an audit client.
13. The Project Team has identified jurisdictional variations in respect of:
- Whether the third party holds interests in the Investment Scheme; however, they do not generally hold a majority ownership or voting control of the Scheme.¹¹
 - Contractual rights and obligations of these third parties.
 - How control and significant influence are determined.

Therefore, depending on the facts and circumstances, these third parties may or may not have control or significant influence over the Scheme. If the third-party does not have control or significant influence over the Scheme, that entity is not a “related entity” under the Code and would not automatically be required to be included in the independence evaluation. The proper application of the conceptual framework in the Code entails consideration of interests, relationships, and circumstances that might directly or indirectly affect the auditor’s independence (however, note the Project Team’s concerns in this regard at [paragraph 37](#)).

Management and Influence Over Financial Statements

14. When performing an audit engagement for an audit client, the auditor must be satisfied that client management makes all judgments and decisions that are the proper responsibility of management.¹² 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.¹³ Examples of activities that would be considered a management responsibility include amongst other things:¹⁴
- Setting policies and strategic direction.

⁹ An entity in respect of which a firm conducts an audit engagement. When the client is a publicly traded entity, in accordance with paragraphs R400.27 of the Code, the audit client will always include its related entities. When the audit client is not a publicly traded entity, audit client includes those related entities over which the client has direct or indirect control.

¹⁰ The Code defines a related entity as an entity that has any of the following relationships with the client:

- (a) An entity that has direct or indirect control over the client if the client is material to such entity;
- (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;
- (c) An entity over which the client has direct or indirect control;
- (d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and
- (e) An entity which is under common control with the client (a “sister entity”) if the sister entity and the client are both material to the entity that controls both the client and sister entity.

¹¹ For example, India and Singapore

¹² Paragraph R400.21 of the Code. This includes ensuring that the client’s management 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.

¹³ Paragraph 400.20 A1 of the Code

¹⁴ Paragraph 400.20 A3 of the Code

- Authorizing transactions.
 - Controlling or managing bank accounts or investments.
 - Reporting to those charged with governance on behalf of management.
 - Taking responsibility for the preparation and fair presentation of the financial statements and/or designing, implementing, monitoring or maintaining internal control.
15. Due to the unique characteristics of Investment Schemes highlighted above, an unrelated third-party to the Scheme might carry out activities relating to day-to-day operations, authorizing transactions, controlling or managing bank accounts or investments, or taking responsibility for the preparation of financial reports. The Project Team has also identified jurisdictional variations in the level of activities undertaken by such third parties, from a single third party being effectively responsible for all of the Scheme's operations, to where the Scheme's operational activities are spread across different third parties.
16. In the circumstances highlighted above, the third-party (and management/employees therein) might be undertaking management responsibilities and might be in a position to exert significant influence over the preparation of the audit client's accounting records or the financial statements on which the firm will express an opinion. However, this does not necessarily mean that the third-party controls or has significant influence over the Investment Scheme (as per the requirements of those definitions). Accordingly, the Project Team is concerned that the existence of control or significant influence might not be the most appropriate factor to determine whether to include an entity or other party in the evaluation of independence in respect of the audit of Investment Schemes.
17. The Project Team is also of the view that where a third party (and management/employees therein) undertakes a significant proportion of the management functions on behalf of an Investment Scheme audit client, or is in a position to exert significant influence over the preparation of that audit client's accounting records or the financial statements on which the firm will express an opinion, the auditor's evaluation of independence should include consideration of whether interests, relationships, or circumstances between the auditor and that third party pose any threats to independence.

Investment Company Complexes

18. The objectives in the Project Team's [Terms of Reference](#) include reviewing investment company complexes (ICCs) and to consider whether the Code should be enhanced to address these structures, such as establishing new terms and definitions, and clarifying which entities and arrangements within such a complex should be considered as related entities of an audit client.¹⁵
19. Under the US SEC rules and regulations, the "audit client" consists of the entity being audited and its affiliates.¹⁶ The definition of "affiliate"¹⁷ is predominantly similar to the definition of "related entity" in

¹⁵ Also refer paragraphs 25 to 33 of the [June 2024 IESBA Agenda Paper](#), which set out some different jurisdictional responses to Investment Schemes and independence.

¹⁶ Refer [SEC 17 CFR Parts 210 Final Rule December 11, 2020](#) Section 210.2-01 Qualifications of Accountants – § 210.2-01(f)(6) *Audit client means the entity whose financial statements or other information is being audited, reviewed, or attested to and any affiliates of the audit client, other than, for purposes of paragraph (c)(1)(i) of this section, entities that are affiliates of the audit client only by virtue of paragraphs (f)(4)(iii), (f)(4)(iv), or (f)(14)(i)(E) of this section.*

¹⁷ § 210.2-01(f)(4) and the meaning of an affiliate of the audit client.

the Code.¹⁸ However, the SEC rule has an additional limb which applies when the entity under audit is an investment company or investment adviser or sponsor, in which case “affiliates” are determined in a different way than for a traditional corporate structure, and consists of each entity in the ICC.¹⁹

20. The current SEC requirements were adopted in 2000, followed by amendments in 2003 and 2020.²⁰ The latter included amendments to the definitions of “affiliate of the audit client” and “investment company complex” *“to address certain affiliate relationships, including entities under common control,”*²¹ and introduced a dual materiality threshold analogous to the Code and AICPA²² provisions for sister entities.²³
21. The ICC rule follows the Independence Standards Board’s (ISB) *Independence Standard No. 2*,²⁴ which included the *“ISB’s basic conclusion that the unique structure of mutual fund complexes warrants special rules of affiliation”*.²⁵ ISB 2 refers to significant differences between the organizational structure of a mutual funds complex (now referred to as an ICC) with a mutual fund-adviser relationship and a typical corporation with a subsidiary-parent relationship.²⁶ The principal differences highlighted are that:
- (a) There is no majority ownership in the mutual fund-adviser relationship (unlike parent-subsidary);
 - (b) The mutual fund’s net income is distributed to the fund’s shareholders and not the related investment adviser (whereas in a typical corporation it goes to the parent); and
 - (c) *“On the other hand, while not having voting control of a fund, the investment adviser usually provides the fund’s officers and performs substantially all services required in its operations, and thus plays an important, even controlling, role in its policies and operations.”*²⁷
22. Under the US SEC rules, the following are notable inclusions of affiliates of the entity under audit in an ICC situation (assuming the entity under audit is an investment company):
- The ICC always includes the investment company’s investment adviser or sponsor, irrespective of whether the investment adviser or sponsor controls or has significant influence over the

¹⁸ Refer to paragraphs 28 to 30 in the Project Team’s [March 2024 IESBA Meeting Agenda Paper](#).

¹⁹ § 210.2-01(f)(4)(v) *Each entity in the investment company complex as determined in paragraph (f)(14) of this section when the entity under audit is an investment company or investment adviser or sponsor, as those terms are defined in paragraphs (f)(14)(ii), (iii), and (iv) of this section.*

²⁰ [SEC.gov | SEC Updates Auditor Independence Rules](#)

²¹ Ibid.

²² American Institute of Certified Public Accountants’ *Code of Professional Conduct*

²³ Page 80534 of [SEC 17 CFR Part 210 Qualifications of Accountants Final Rule](#).

²⁴ [ISB Standard No. 2, Certain Independence Implications of Audits of Mutual Funds and Related Entities \(pcaobus.org\)](#)

²⁵ Refer to page 76060 of [SEC 17 CFR Parts 210 and 240 Revision of the Commission’s Auditor Independence Requirements December 5, 2000](#)

²⁶ Refer to paragraph 15 of [ISB Standard No. 2, Certain Independence Implications of Audits of Mutual Funds and Related Entities \(pcaobus.org\)](#)

²⁷ Refer to paragraph 15 of [ISB Standard No. 2, Certain Independence Implications of Audits of Mutual Funds and Related Entities \(pcaobus.org\)](#)

investment company.²⁸

- The ICC includes an entity controlled by the investment adviser or sponsor if that entity provides administrative, custodial, underwriting, or transfer agent services to the investment company or investment adviser or sponsor.²⁹
- The ICC includes any entity under common control (sister entity) with the investment company or investment adviser or sponsor if that entity is providing administrative, custodial, underwriting, or transfer agent services to the investment company or investment adviser or sponsor.³⁰

Additional detail is included in [Appendix 3](#) which compares the above inclusions of affiliates in an ICC to the Code's related entity definition.

The International Standards on Auditing

23. Since the June 2024 IESBA meeting, the Project Team has engaged with IAASB staff to obtain a better understanding of how ISAs apply in the context of Investment Scheme audits.
24. As the ISAs do not specifically address these types of structures, the following principles embedded in the ISAs are applicable:
- The auditor has sole responsibility for the audit and expresses an audit opinion on the reporting entity's³¹ financial statements.
 - The auditor needs to obtain sufficient appropriate audit evidence to be able to express an opinion on the financial statements. This can be obtained either by the auditor themselves or through using the work of others.³²

²⁸ SEC Rule 17 CFR § 210.02(f)(14)(i)(B) *The investment adviser or sponsor of any investment company identified in paragraph (f)(14)(i)(A)(1) of this section;*

²⁹ SEC Rule 17 CFR § 210.02(f)(14)(i)(C) (noting it is a sister entity of any affiliate identified in A, B, or C of this section, so not just sister entities of the entity under audit) *Any entity controlled by or controlling:*

- 1) *An entity under audit identified by paragraph (f)(14)(i)(A) of this section, or*
- 2) *An investment adviser or sponsor identified by paragraph (f)(14)(i)(B) of this section.*

When the entity is controlled by an investment adviser or sponsor identified by paragraph (f)(14)(i)(B), such entity is included within the investment company complex if:

- (i) *The entity and the entity under audit are each material to the investment adviser or sponsor identified by paragraph (f)(14)(i)(B) of this section; or*
- (ii) *The entity is engaged in the business of providing administrative, custodial, underwriting, or transfer agent services to any entity identified by paragraphs (f)(14)(i)(A) or (B) of this section.*

³⁰ SEC Rule 17 CFR § 210.02(f)(14)(i)(D) *Any entity under common control with an entity under audit identified by paragraph (f)(14)(i)(A) of this section, any investment adviser or sponsor identified by paragraph (f)(14)(i)(B) of this section, or any entity identified by paragraph (f)(14)(i)(C) of this section; if the entity:*

- 1) *Is an investment company or an investment adviser or sponsor, when the entity and the entity under audit identified by paragraph (f)(14)(i)(A) of this section are each material to the controlling entity; or*
- 2) *Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any entity identified by paragraphs (f)(14)(i)(A) and (f)(14)(i)(B) of this section.*

³¹ For example, the Investment Scheme.

³² Such as a component auditor, management expert, practitioner's expert, internal auditors or service auditor.

- A reporting entity is required to have an audit performed on an annual basis in accordance with a jurisdiction's laws or regulations. Management of the reporting entity will appoint an auditor to perform the audit engagement and is responsible for ensuring that the necessary internal controls, information system and reporting process are in place.³³
25. The Project Team analyzed how the Code and ISA's³⁴ define *those charged with governance and management*. The definition of those charged with governance³⁵ is the same in both the Code and ISA 260 (Revised). However, the Code does not include a definition of management, whereas ISA 260 (Revised) defines management as:

The person(s) with executive responsibility for the conduct of the entity's operations. For some entities in some jurisdictions, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.

Due to diversity in governance structures, ISA 260 (Revised) recognizes that in some cases those charged with governance are responsible for approving the entity's financial statements while in other cases, management has the responsibility.³⁶

26. Irrespective of the way responsibilities for financial reporting are divided between management and those charged with governance, ISA 580³⁷ requires the auditor to request management to provide written representations that it has carried out those matters for which it is responsible. The concept of an independent audit requires that the auditor's role does not involve taking responsibility for the preparation of the financial statements or the entity's related internal controls, and that the auditor has a reasonable expectation of obtaining the information necessary for the audit in so far as management is able to provide or procure it. Accordingly, the premise of independence is

³³ Under paragraph 6(b) of ISA 210: *Agreeing the Terms of Audit Engagements* (ISA 210), management and, where appropriate, those charged with governance acknowledge and understand that they have the following responsibilities that are fundamental to the conduct of an audit in accordance with ISAs. That is, responsibility:

- (a) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
- (b) For such internal control as management and, where appropriate, those charged with governance determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (c) To provide the auditor with:
 - (i) Access to all information of which management and, where appropriate, those charged with governance are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - (ii) Additional information that the auditor may request from management and, where appropriate, those charged with governance for the purpose of the audit; and
 - (iii) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

³⁴ ISA 260 (Revised): *Communication with Those Charged with Governance*

³⁵ The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

³⁶ Paragraph A1 of ISA 260 (Revised): *Communication with Those Charged with Governance*.

³⁷ Paragraphs 10 – 11 of ISA 580: *Written Representations*.

fundamental to an audit.³⁸

27. Due to the unique characteristics of Investment Schemes, third parties could perform activities that would be regarded as management responsibilities. The Project Team observed that some jurisdictions have addressed this by enacting laws and regulations that mandate particular considerations for auditor independence.³⁹ In such circumstances where laws and regulations in a jurisdiction are more stringent than the Code, such laws and regulations will prevail (paragraphs R100.6 to 100.7 A1).

ISA 402: Audit Considerations Relating to an Entity Using a Service Organization

28. As mentioned in [paragraph 24](#), an auditor can make use of the work of others to obtain the necessary audit evidence for purposes of expressing an opinion on the financial statements of the reporting entity. As per ISA 402,⁴⁰ services provided by a service organization are relevant to the audit of an entity's financial statements when those services, and the controls over them, are part of the entity's information system, and relevant to the preparation of the financial statements. Factors the auditor of the user entity will consider include:⁴¹
- The nature of the service provided and the significance of those services, including the effect thereof on the audited⁴² entity's internal controls;
 - Nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organization;
 - The degree of interaction between the activities of the service organization and those of the audited entity, and
 - The nature of the relationship between the audited entity and the service organization, including the relevant contractual terms of the activities undertaken by the service organization.
29. As ISA 402 does not include specific reference to the Code, the overarching principle for an auditor to evaluate their compliance with relevant ethical requirements, including those related to independence, as it relates to a service organization would apply. The Project Team is of the view that the factors regarding the nature of the services provided, the materiality of the transactions processed, the level of impact of the services on the financial reporting processes, and the nature of the contractual relationship between the audited Scheme and the service organization, should be considered by the auditor when assessing independence.

III. The IESBA Code

30. The Code provides that it is in the public interest that PAs be independent when performing audit engagements.⁴³ To meet this objective, the Code requires firms to comply with the fundamental principles and apply the conceptual framework when performing such engagements.

³⁸ Paragraph A11 of ISA 210: *Agreeing the Terms of Audit Engagement*

³⁹ Refer to paragraphs 25 to 33 of [Agenda Paper 3A](#) from the June 2024 IESBA meeting.

⁴⁰ Paragraph 3 of ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

⁴¹ Paragraph 9 of ISA 402

⁴² The term "user entity" is used in ISA 402

⁴³ Paragraphs 400.1 and R400.18 of the Code

31. Part 4A contains material setting out how PAs should apply the conceptual framework to maintain independence.⁴⁴ These provisions establish steps and factors to consider when applying the conceptual framework to particular situations or circumstances (e.g., financial interests, business relationships, family and personal relationships and non-assurance services). Part 4A also sets out specific prohibitions for certain services, interests, relationships, or circumstances when the threats cannot be eliminated and safeguards are not capable of being applied to reduce the threats to an acceptable level.
32. These provisions include specific paragraphs where the auditor should consider their independence from not only the audit client but also the client's management and those who are in positions to exert significant influence over the financial records or financial statements of the audit client.
33. The Project Team is of the view that the Code does not contain specific provisions that directly address the matters that auditors should consider in circumstances where unrelated third parties are not captured by the Code's definitions of "audit client" and "related entity" if they are not regarded as having control or significant influence over an Investment Scheme.
34. The Project Team believes that the Code should address unrelated third parties, such as the investment advisor, asset management company, or sponsor that carry out tasks for the Scheme and play an important role in relation to its policies and operations, by, for example:
- Maintaining financial records;
 - Conducting transactions in accordance with the Scheme's trust deed/initial statement; and
 - Managing the Schemes overarching strategy, which may involve choosing or hiring other service providers.

Because these unrelated third parties carry out responsibilities similar to those performed by in-house management in a traditional corporate structure, the Project Team is of the view that the auditor should be required to assess whether interests, relationships, or circumstances between the auditor and the unrelated third parties pose any threats to the auditor's independence when performing the audit of the Scheme, notwithstanding that these unrelated third parties do not meet the criteria specified by the "related entity" definition.

35. The merit of this approach is reinforced when one considers that the Code includes auditor independence requirements relating to an employee that is in a position to exert significant influence over the audit client's accounting records or financial statements.⁴⁵ Investment Schemes typically do not have their own workforce but instead rely on external service providers to carry out various tasks. The Project Team is of the view that it could be made clearer that in such circumstances, the auditor should be required to evaluate their independence from those individuals employed by the third party who are in a position to exert significant influence over the Investment Scheme's accounting records or financial statements.
36. Similarly, before accepting a new or continuing with an engagement a PA is required to identify circumstances that might create a conflict of interest resulting in a threat to compliance with one or more of the fundamental principles.⁴⁶ Steps to identify conflicts of interest include determining the

⁴⁴ Paragraphs 400.6 and R400.19 of the Code

⁴⁵ For example, paragraphs R521.5 and R522.3 of the Code amongst others

⁴⁶ Paragraph R310.5 of the Code

nature of the relevant interests and relationships between parties involved and any implications for the relevant parties. This requires a PA to have an appropriate understanding of the structure, role and responsibilities of all parties involved.⁴⁷

37. The Project Team considers that even though the above conclusions might be reached by applying the conceptual framework, this would require a comprehensive and nuanced interpretation of the Code and its interrelated provisions, the exercise of professional judgment and the use of the reasonable and informed third party test.
38. To ensure consistent application of the Code's principles when auditing Investment Schemes, the Project Team believes that it would be in the public interest for the matters identified above to be addressed by the inclusion in the Code of specific independence provisions to address the considerations arising from these types of structures.

IV. Pension Funds

39. To date the Project Team's outreach and research has noted similarities and differences between pension funds and CIVs which are summarized in [Appendix 4](#). Due to some distinct differences between the two types of investment vehicles, the Project Team will continue to consider the unique characteristics of pension funds and the implications for the Code.

V. Questions for Board discussion

40. IESBA members are asked to consider the following questions to assist in developing a way forward:
 - (a) Do you agree with the Project Team's analysis that there is a gap in the Code regarding the auditor's evaluation of the auditor's independence from Investment Schemes with respect to interests, relationships or circumstances involving the auditor with unrelated third parties, e.g., investment advisors, fund managers, and sponsors? If not, please explain why.
 - (b) With respect to the examples of activities that would be considered a management responsibility set out in [paragraph 14](#) above (see also paragraph 400.20 A3⁴⁸ of the Code):
 - (i) Do you think they are relevant in assessing whether an unrelated third party should be part of the independence assessment?

⁴⁷ Factors relevant to evaluating the level of threat included in paragraphs 320.3 A2 and 320.3 A4 of the Code

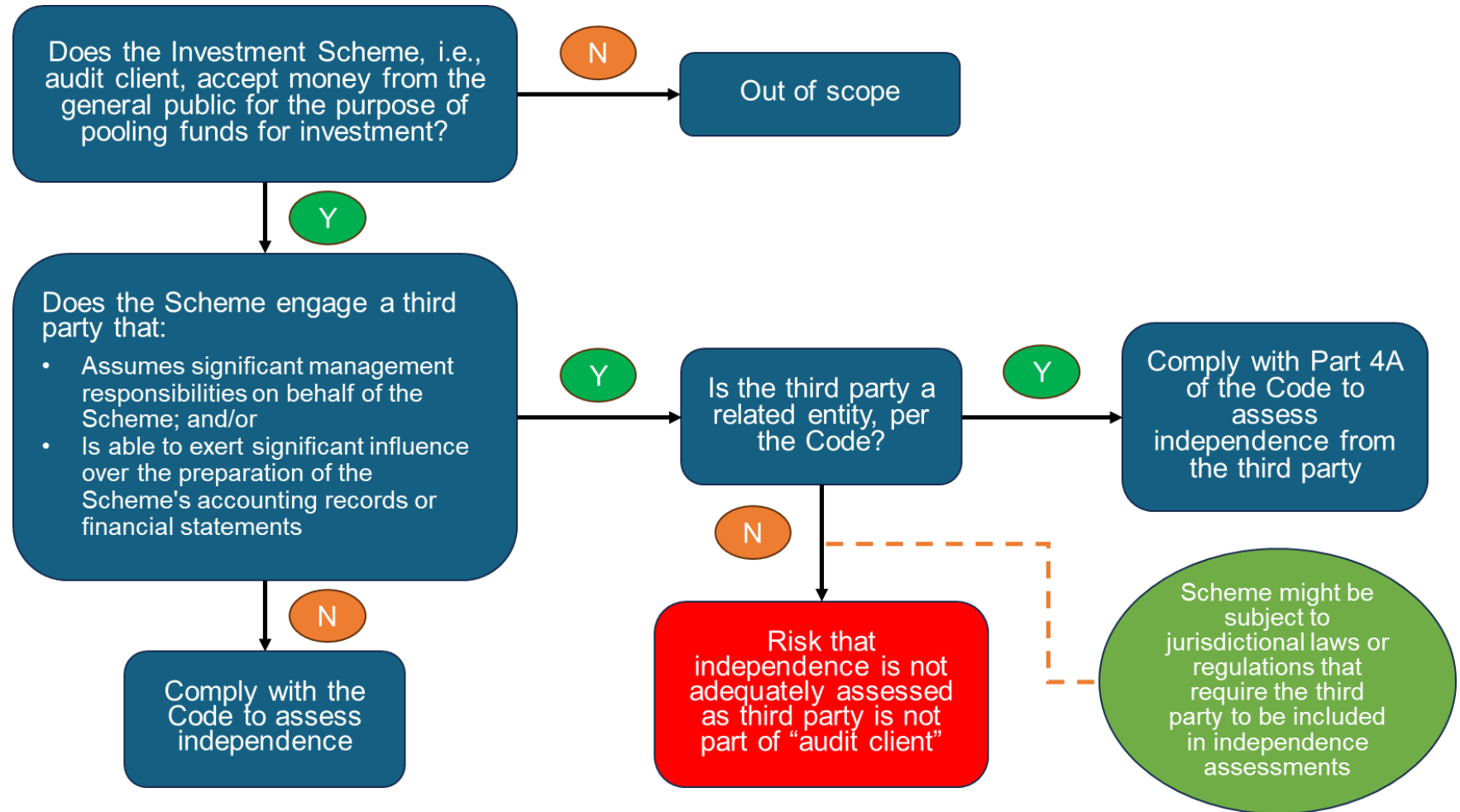
⁴⁸ Determining whether an activity is a management responsibility depends on the circumstances and requires the exercise of professional judgment. Examples of activities that would be considered a management responsibility include:

- 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.
 - Designing, implementing, monitoring or maintaining internal control.

- (ii) Are there any other factors that should be considered?
- (c) Do you support engaging more broadly with stakeholders for their input on the issues discussed in this section, for example, through the issuance of a discussion or consultation paper, to further inform the Board's considerations and the next steps?

Appendix 1

Flowchart Demonstrating the Gap in the Code for Investment Schemes



Agenda Item 4-A

IESBA Meeting (September 2024)

Appendix 2

Table 1: List of Stakeholders Engaged to Date

| Abbrev. | Respondent | Region |
|----------|---|---------------|
| ASF | Autoridade de Supervisão de Seguros e Fundos de Pensões (Portugal) | Europe |
| AICPA | American Institute of Certified Public Accountants (ICC and Employee Benefit Plan Audit Quality Center experts) | North America |
| APESB | Accounting Professional & Ethical Standards Board (Australia) | Asia Pacific |
| Assirevi | Association of Italian Audit Firms | Europe |
| AUASB | Auditing and Assurance Standards Board, Australia | Asia Pacific |
| CPAC | Chartered Professional Accountants Canada | North America |
| CPAK | Capital Markets Authority of Kenya | Africa |
| ESMA | European Securities and Markets Authority | Europe |
| EY | Ernst & Young Global Limited | Global |
| GT | Grant Thornton International Limited (United States) | North America |
| IAASB | International Auditing and Assurance Standards Board | Global |
| IRBA | Independent Regulatory Board for Auditors | Africa |
| ISCA | Institute of Singapore Chartered Accountants | Asia Pacific |
| JICPA | Japanese Institute of Certified Public Accountants | Asia Pacific |
| KEPFIC | Kenya Pension Fund Investment Consortium | Africa |
| MAS | Monetary Authority of Singapore | Asia Pacific |
| NSS | National Standard Setters | Global |
| OCRI | ON Valor Relações com Investidores | South America |
| PFRDA | Pension Fund Regulatory & Development Authority (India) | Asia Pacific |
| PwC | PricewaterhouseCoopers International Limited | Global |
| SA | Spearhead Africa (Kenya) | Africa |

| Abbrev. | Respondent | Region |
|---------|--|---------------|
| SEBI | Securities and Exchange Board of India | Asia Pacific |
| SEC | United States Securities and Exchange Commission | North America |

Table 2: Jurisdictions Represented by Stakeholders Engaged

| Country | | Region | Considered as Public Interest Entity (PIE) ⁴⁹ | |
|---------|--------------------------|---------------|--|---------------|
| | | | CIVs | Pension Funds |
| 1 | Australia | Asia Pacific | Yes | Yes* |
| 2 | Bahrain | Middle East | No | No |
| 3 | Brazil | South America | Yes | No |
| 4 | Canada | North America | Yes | No |
| 5 | France | Europe | No | No |
| 6 | Hong Kong | Asia Pacific | No | No |
| 7 | India | Asia Pacific | No | No |
| 8 | Ireland | Europe | No | No |
| 9 | Italy | Europe | Other ⁵⁰ | No* |
| 10 | Japan | Asia Pacific | No | No |
| 11 | Kenya | Africa | No | No |
| 12 | Luxembourg | Europe | No | No |
| 13 | Portugal | Europe | No | Yes* |
| 14 | Singapore | Asia Pacific | No* | Yes* |
| 15 | Saudi Arabia | Middle East | No | No |
| 16 | South Africa | Africa | Yes* | Yes* |
| 17 | United Arab Emirates | Middle East | No | No |
| 18 | United States of America | North America | No | No |

* Fund managers, investment companies and asset managers are regarded as PIEs in the case of CIVs.
Pension fund managers and trustees regarded as PIEs in the case of Pension Funds

⁴⁹ As per the [Database of Public Interest Entity \(PIE\) Definition by Jurisdiction](#).

⁵⁰ Entities subject to an intermediate regime to which only certain PIE independence requirements are applicable.

Appendix 3

Comparison between US SEC Rules and the Code

The following table sets out some notable inclusions of affiliates in an ICC compared to the Code's related entity definition (assuming the entity under audit/audit client is an investment company):

| SEC – Investment Company Complex ⁵¹ | The Code – Audit Client & Related Entities |
|---|---|
| The ICC <u>always includes</u> the investment company's investment adviser or sponsor as affiliates. This is irrespective of whether the investment adviser or sponsor controls or has significant influence over the investment company. ⁵² | The Code only includes the investment company's investment adviser or sponsor as a "related entity" if the: <ul style="list-style-type: none"> - Investment adviser or sponsor controls or has significant influence over the investment company and if the investment company is material to the investment adviser or sponsor; or - Investment company and the investment adviser or sponsor are under common control and both the investment company and the investment adviser or sponsor are material to the entity that controls them.⁵³ |
| The ICC includes an entity controlled by the investment adviser or sponsor if that entity: ⁵⁴ | Entities downstream and upstream from the investment adviser or sponsor would not be related |

⁵¹ SEC Rule 17 CFR § 210.02(f)(14)(i)

⁵² SEC Rule 17 CFR § 210.02(f)(14)(i)(B) *The investment adviser or sponsor of any investment company identified in paragraph (f)(14)(i)(A)(1) of this section;*

⁵³ Definition of "related entity" in the Code (a), (b), or (e):

- (a) *An entity that has direct or indirect control over the client if the client is material to such entity;*
- (b) *An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity;*
- (e) *An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity.*

⁵⁴ SEC Rule 17 CFR § 210.02(f)(14)(i)(C) (noting it is a sister entity of any affiliate identified in A, B, or C of this section, so not just sister entities of the entity under audit) *Any entity controlled by or controlling:*

- 1) *An entity under audit identified by paragraph (f)(14)(i)(A) of this section, or*
- 2) *An investment adviser or sponsor identified by paragraph (f)(14)(i)(B) of this section.*

When the entity is controlled by an investment adviser or sponsor identified by paragraph (f)(14)(i)(B), such entity is included within the investment company complex if:

- (iii) *The entity and the entity under audit are each material to the investment adviser or sponsor identified by paragraph (f)(14)(i)(B) of this section; or*
- (iv) *The entity is engaged in the business of providing administrative, custodial, underwriting, or transfer agent services to any entity identified by paragraphs (f)(14)(i)(A) or (B) of this section;*

| SEC – Investment Company Complex ⁵¹ | The Code – Audit Client & Related Entities |
|---|---|
| <ul style="list-style-type: none"> - And the investment company are both material to the investment adviser or sponsor; or - Provides administrative, custodial, underwriting, or transfer agent services to the investment company or investment adviser or sponsor. | <p>entities unless the investment adviser or sponsor controls the investment company and subject to materiality tests.</p> |
| <p>Any entity under common control (sister entity) with the investment company or investment adviser or sponsor if that entity is:⁵⁵</p> <ul style="list-style-type: none"> - An investment company or investment adviser or sponsor (i.e., different ones) and it and the entity under audit (the investment company) are each material to the controlling entity; or - Providing administrative, custodial, underwriting, or transfer agent services to the investment company or investment adviser or sponsor. | <p>Sister entities of the investment company are related entities where the sister entity and the investment company are both material to the entity that controls the sister entity and the investment company.</p> <p>Therefore, sister entities of the investment adviser or sponsor would not be related entities. Further, if the sister entity and/or the investment company are not material to the entity that controls them, then the sister entity is not a related entity even if providing administrative, custodial, underwriting, or transfer agent services to the investment company.</p> |

⁵⁵ SEC Rule 17 CFR § 210.02(f)(14)(i)(D) *Any entity under common control with an entity under audit identified by paragraph (f)(14)(i)(A) of this section, any investment adviser or sponsor identified by paragraph (f)(14)(i)(B) of this section, or any entity identified by paragraph (f)(14)(i)(C) of this section; if the entity:*

- 1) *Is an investment company or an investment adviser or sponsor, when the entity and the entity under audit identified by paragraph (f)(14)(i)(A) of this section are each material to the controlling entity; or*
- 2) *Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any entity identified by paragraphs (f)(14)(i)(A) and (f)(14)(i)(B) of this section;*

Appendix 4

Pension funds

The Project Team’s research revealed that there are many similarities between CIVs and pension funds which include:

- Entities are regulated (i.e., pension fund and pension fund administrators).
- Unique structures similar to CIVs.
- Contributions are invested by a third party (pension fund advisor) in accordance with an underlying foundational document/agreement.
- Third parties are engaged to perform services on behalf of the pension fund. These third parties do not generally own or control the pension fund, but are bound by a contract or agreement to act on behalf of the beneficiaries of the pension fund.

There are however key differences between CIVs and pension funds that can be summarized as follows:

| CIVs | Pension Fund |
|---|---|
| Primarily designed to pool funds from multiple investors to invest in a diversified portfolio of assets with focus on achieving capital growth, income, or a combination of both, depending on the scheme’s objectives. | Specifically designed to provide retirement income, focusing on long-term growth to ensure sufficient funds for retirees, often with a conservative approach to risk. |
| Various forms such as mutual funds, unit trusts or investment funds. | Can be defined benefit or defined contribution plans or a hybrid between of the two. |
| Available to a wide range of investors, including individuals and institutions. | Often available only to employees of the sponsoring employer. ⁵⁶ |

Where pension funds have similar characteristics as CIVs analyzed, the Project Team has the same concerns about the risks associated with auditor independence. As noted with CIVs, some jurisdictions have addressed this by enacting laws, regulations, or professional obligations that mandate particular considerations for auditor independence when the audit engagement involves pension funds. An example is the AICPA *Code of Professional Conduct* (AICPA Code) “affiliate” definition which include entities of which the auditor must be independent.⁵⁷

⁵⁶ Exceptions exist for example in Australia for self-managed superannuation funds.

⁵⁷ Refer to Appendix 3 of the [June 2024 IESBA meeting](#) papers.