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**Re: Exposure Draft, Proposed Revisions to the Code Relating to  
the Definition of Engagement Team and Group Audits**

Dear Ken,

We would like to thank you for the opportunity to provide the IESBA with our comments on the Exposure Draft: "Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits", hereinafter referred to as "the Proposal".

Before addressing some of the individual questions raised in the Proposal in the appendix to this letter, we provide some general comments.

**Support for the Initiative**

We support this initiative and agree that the IESBA should both align certain definitions with those of the IAASB in ISA 220 (Revised) and ISA 600 (Revised) and ISQM 1, where appropriate, and stipulate specific independence requirements in order to clarify what the term "relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement" as used in ISA 600 (Revised) 25 and 27 and 45 means for component auditors in a group audit.

GESCHÄFTSFÜHRENDER VORSTAND:  
Prof. Dr. Klaus-Peter Naumann,  
WP StB, Sprecher des Vorstands;  
Dr. Daniela Kelm, RA LL.M.;  
Melanie Sack, WP StB

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## Issues for Sustainability-Related Assurance – Independence

We note that IESBA has not discussed the issue of sustainability-related assurance as part of the audit of group financial statements in its consideration of this initiative. We would therefore urge the IESBA to fully investigate the implications in considering how the Code might need to change to address this, bearing in mind the following:

### *Potential Impact on the Audit/Assurance Market*

In this context, we are concerned that further changes relating to ESG assurance as part of the audit of group financial statements – should they reflect a stance similar to that of the Proposal – can potentially have a significant impact on the audit/assurance markets, when assurance procedures need to be performed on ESG information stemming from a reporting entity’s supply chains that the entity has to report and that thus becomes subject to assurance.

In our comment letter to the IAASB dated May 26, 2021 relating to the ED “Conforming and Consequential Amendments to the IAASB’s Other Standards as a Result of the New Revised Quality Management Standards”, we noted that the impact of the change in IAASB’s definition of “engagement team” on engagements performed in accordance with ISAE 3000 (Revised) and in particular those engagements that encompass information from supply chains outside of corporate groups demands thorough investigation by the IAASB together with the IESBA prior to the incorporation of this new definition in ISAE 3000 (Revised). Below is a quote from the afore-mentioned comment letter, which explains our concerns as to independence requirements more fully:

“In the short run, this issue will be substantially exacerbated by laws in the process of being developed within some EU member states that make entities over a certain size responsible for the compliance of suppliers outside of the EU with national social responsibility requirements, and by the current draft of the EU directive that will make assurance (using ISAE 3000, for example) on corporate social responsibility reports mandatory for entities over a certain size as part of the statutory financial statement audit. It is unclear to us at this stage of analysis what the implications are of the engagement team definition to the application of independence requirements for statutory financial statements as set forth by EU law for PIEs (including the "blacklist") to practitioners assuring information in the upstream supply chain for the purposes of the statutory financial statement audit, but not otherwise involved in assuring information within a group. It is not unthinkable that the extension of these independence requirements to all firms in the supply chain may accelerate a

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movement towards audit-only (or at least, assurance-only) firms internationally, which we believe is not the intention of the change in the definition of engagement team.”

For example, in a group audit situation, the parent entity may have control of (or at least have significant influence over) components, whose financial information is subject to consolidation, which facilitates access to their financial information needed for financial reporting purposes and to component auditors whose work is needed for the group audit. This is not the case when ESG information from outside the group or entity is required to be reported together with the group financial statements but needs to be obtained from potentially a multitude of different entities within the upstream and downstream supply chain, where management is unlikely to be in a similarly strong position to access such information or direct a supply-chain entity’s management to ensure that the group auditor has access to another assurance practitioner performing procedures on supply chain information as part of the audit of the group financial statements. Our concern is that an extension of independence requirements to those performing procedures on supply chain information could be unworkable in practice and thus serve to accelerate a movement towards audit-only (or assurance-only firms).

#### *Considerations as to the Scope of the Code*

As the IESBA is aware, there are currently significant developments in the pipeline both at an international level and, of most relevance to our members, in the EU where various issues are currently under discussion, including whether others (including e.g., environmental engineers, consultancy practitioners etc.) than professional accountants may be permitted to provide assurance services in respect of sustainability-related reporting, the scope of entities required to report on sustainability-related information, the content of their reporting as well as the placement of that information.

We therefore also support the IESBA considering its own role in this arena, i.e., how the IESBA Code could be amended so as to apply to those individuals who play a significant role in both preparation and assurance of sustainability-related information who are not already required to adhere to the IESBA Code. This would include both preparers of sustainability reporting that are not professional accountants in business, and those performing assurance engagements on corporate sustainability reporting beyond those who are members of the professional accountancy profession.

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### **The Need for a Proportionate Approach**

As we discuss in our responses in the appendix to this letter, we suggest that IESBA reconsider its proposals to require the most stringent PIE independence requirements to be required for all work performed by a component auditor on every component that is itself not a PIE but within a group whose parent company is a PIE and instead prescribe a proportionate approach. In respect of group audit or assurance work involving assurance practitioners outside the group performing procedures on supply chain information, we would similarly urge IESBA instead to develop a proportionate approach recognizing the relative level of significance of the work performed

### **Potential Impact of the Proposals relating to Component Auditor Independence on the Audit Market**

A further concern – especially amongst, but not limited to, SMPs in our jurisdiction – is that the proposals, if adopted, may have significant consequences in the audit market as we discuss in our responses in the appendix to this letter and outlined below.

Proposed R405.19 of the IESBA's proposal would exacerbate the concern, which the IDW had noted in responding to the IAASB's ED ISA 600. In the context of ISA 600, our concern was that the change to the definition of "engagement team" would have a significant practical impact in a group audit because it results in a requirement for the group auditor to direct, supervise and review the work all component auditors. For example, a non-group auditor network firm may perform a statutory audit of a component that is a non-PIE and thus apply the provisions of the Code applicable to non-PIEs (in practice, for SMEs the fee related provisions could be an issue as could the client's request for permissible non-audit services that would be of benefit to that (often SME) component), whereas if the parent entity is a PIE the proposals would require that firm perform group audit procedures under PIE-requirements of the Code to be used by the group auditor. Thus, in the event that the non-network has performed such a statutory audit, it is possible that none or little of the work done by this firm could be used for group audit purposes and thus may have to be duplicated. Of course, a group auditor could instruct such a component auditor to perform all work under the Code's PIE independence requirements, but this could be difficult for some smaller firms (fee thresholds) or prevent the client benefiting from the provision of (non-PIE permissible) NAS.

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We therefore urge the IESBA to prescribe a proportionate approach that recognizes the relative significance of the component to the group audit combined with the relative ability of procedures performed by a non-network component auditor to directly influence the outcome of the group audit, rather than to require all audit work on the financial information of that component performed by a non-network component auditor on the group audit be performed under the PIE ethical requirements because the parent company is a PIE.

### **Excessive Complexity will hinder the Application of the Code in Practice**

In responding to questions 1 and 2 we note unhelpful complexities that impact the understandability of the Code. We also believe that the incidence of cross references to “relevant“ but unspecified material elsewhere in the Code e.g., in proposed paragraphs R405.3, R405.4 and R405.5, is unhelpful and will lead to considerable difficulty in practice in the context of understanding the practical application of such requirements.

In our opinion, the Code needs to be drafted in a clear and concise manner in order for it to be easy to understand and apply.

We would be pleased to provide you with further information if you have any additional questions about our response and would be pleased to be able to discuss our views with you.

Yours truly,

Melanie Sack  
Deputy Chief Executive Officer  
Chief Operating Officer

Gill Waldbauer  
Head of International Affairs

## Appendix

### Specific Questions

#### **Proposed Revised Definition of Engagement Team**

1. *Do you agree with the proposed changes to the Code related to the revised definition of ET, including: (see Chapters 1, 4 and 6)*
  - a) *The revised definitions of the terms “engagement team,” “audit team,” “review team” and*
  - b) *“assurance team;” and*
  - c) *The explanatory guidance in paragraphs 400.A – 400.D?*

We agree that having different definitions of the same terms in the ISAs and the IESBA Code is unhelpful and thus support alignment.

The current IESBA proposals have, however, added complexity. We are concerned that the inclusion of a defined term within a definition makes the requirements especially difficult to follow in practice. We are also concerned that not all of the implications of the changes in the definitions have been adequately explored.

#### **Independence Considerations for Engagement Quality Reviewers**

2. *Do you agree with the changes to the definitions of “audit team,” “review team” and “assurance team” to recognize that EQRs may be sourced from outside a firm and its network (see Chapter 6)?*

Whilst we agree that it is necessary to clarify the independence requirements for EQRs, we question the rationale for the Code to include such complex terms. Having numerous definitions including definitions within definitions unnecessarily adds complexity to the Code and may be detrimental to its understandability.

### Independence in a Group Audit Context

3. *Do you agree with the proposed new defined terms that are used in Section 405 in addressing independence considerations in a group audit (see Chapters 1 and 6)?*

See above. An explanation of what is meant by “all others who can directly influence the outcome of the group audit” would be helpful. Does “directly influence outcome” refer to an ability to cause a modification of the group auditor’s opinion, influence the group auditor’s decision as to the inclusion or wording of an EoM or KAM or other matters paragraph? Or does the IESBA intend this to have a different meaning in practice?

4. *In relation to the proposals in Section 405 (Chapter 1), do you agree with the principles the IESBA is proposing for:*
- (a) *Independence in relation to individuals involved in a group audit; and*
  - (b) *Independence in relation to firms engaged in a group audit, including CA firms within and outside the GA firm’s network?*

- (a) As we have commented in the past, we see merit in requiring all individuals involved in an audit be independent of the audit client, although we do still see an argument for the IESBA to adopt a more practicable and proportionate approach that includes de minimis exceptions in this context. The more complex the Code becomes, the more likely that isolated breaches that are inadvertent, unintentional, and insignificant will occur, even breaches that the individual is unaware of at the time of engagement performance – i.e., breaches that do not impact an individual’s independence in fact at all.

In requiring the group auditor to inform those charged with governance of all breaches the Proposal compounds the practicality issue, as this requirement will likely lead to “irritation” and a desire for simplification. We therefore suggest the IESBA should reconsider its no tolerance stance in paragraph R405.9 and consider whether a proportionate approach that includes de minimis exceptions to the independence provisions might instead be applicable to all individuals concerned with an audit.

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

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consideration by IESBA of the practicalities or potential impacts of its proposals.

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

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

Further comments on section 405:

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



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counterintuitive. Thus, the wording should either refer to it not being necessary or if “shall apply” is retained it should be presented as one of two alternatives.

5. *Concerning non-network CA firms, do you agree with the specific proposals in Section 405 regarding:*
- (a) Financial interest in the group audit client; and*
  - (b) Loans and guarantees?*

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

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

### **Non-Assurance Services**

6. *Is the proposed application material relating to a non-network CA firm’s provision of NAS to a component audit client in proposed paragraph 405.12 A1 – 405.12 A2 sufficiently clear and appropriate?*

It would be helpful to highlight the authority of passages that constitute negative requirements in 405.12.A2 and the first sentence of 405.18 A1.

### **Changes in Component Auditor Firms**

7. *Is the proposed application material relating to changes in CA firms during or after the period covered by the group financial statements in proposed paragraph 405.13 A1 – 405.13 A2 sufficiently clear and appropriate?*

Yes, subject to our suggestions that the IESBA prescribe a proportionate approach.

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### **Breach of Independence by a Component Auditor Firm**

8. *Do you agree with the proposals in Section 405 to address a breach of independence by a CA firm?*

As explained above, we suggest that an approach that includes de minimis exceptions be considered, as we suspect that the Proposal will lead to irritation and potentially be a further factor in driving changes in the audit market.

### **Proposed Consequential and Conforming Amendments**

9. *Do you agree with the proposed consequential and conforming amendments as detailed in Chapters 2 to 6?*

We have no specific issues with the Proposal's approach to conforming amendments other than our comments above as to the complexity of having so many defined terms and some definitions including defined terms themselves.

### **Effective Date**

10. *Do you support the IESBA's proposal to align the effective date of the final provisions with the effective date of ISA 600 (Revised) on the assumption that the IESBA will approve the final pronouncement in December 2023?*

In principle we agree that different effective dates would be unhelpful. However, we urge the Boards to work more closely together in determining a suitable effective date for connected projects, rather than one Board setting an effective date essentially for the other to follow. In this case ISA 600 (Revised) was finalized a whole year before IESBA anticipates finalizing this Proposal. An effective date for audits of financial statements for periods beginning on or after December 15, 2023, will be challenging in practice as we agree with IESBA's supposition that some of the proposals may entail significant changes to the policies and methodologies of firms and networks that perform or are otherwise involved in group audits, including increased costs, e.g., with respect to the deployment of updated policies and procedures, and awareness raising and training initiatives.

This "haste" for affected firms to be ready is a further factor that may make it "easier" for group auditors not to use the work of a non-network component auditor.

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### **Request for General Comments**

In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:

- *Small- and Medium-sized Entities (SMEs) and SMPs* – The IESBA invites comments regarding any aspect of the proposals from SMEs and SMPs.

In our opinion the impact on the presence and role of SMPs in the audit market is likely to be significant. We have commented specifically on this issue above.

- *Regulators and Audit Oversight Bodies* – The IESBA invites comments on the proposals from an audit inspection or enforcement perspective from members of the regulatory and audit oversight communities.

N/A.

- *Developing Nations* – Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular on any foreseeable difficulties in applying them in their environment.

N/A.

- *Translations* – Recognizing that many respondents may intend to translate the final changes for adoption in their own environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.

We have not identified any specific translation issues at this stage.