

## Engagement Team – Group Audits Independence (Clean)

### INTERNATIONAL INDEPENDENCE STANDARDS (PARTS 4A AND 4B)

#### PART 4A – INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

##### SECTION 400

#### APPLYING THE CONCEPTUAL FRAMEWORK TO INDEPENDENCE FOR AUDIT AND REVIEW ENGAGEMENTS

##### Introduction

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- 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.
- 400.2 This Part applies to both audit and review engagements. The terms “audit,” “audit team,” “audit engagement,” “audit client,” and “audit report” apply equally to review, review team, review engagement, review client, and review engagement report.
- 400.3 This Part applies to all members of the audit engagement team, including component auditors performing audit procedures in a group audit. Section 405 sets out independence provisions applicable in a group audit.

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##### Engagement Team and Audit Team

- 400.A An engagement team for an audit of financial statements includes partners and staff in the firm who perform audit procedures on the engagement, and any other individuals who perform such procedures who are from:
- (a) A network firm; or
  - (b) A firm that is not a network firm, or another service provider.
- For example, an individual from a component auditor firm who performs audit procedures on the financial information of a component in a group audit is a member of the engagement team for the group audit.
- 400.B In ISQM 1, a service provider includes an individual or organization external to the firm that provides a resource that is used in the performance of an engagement. Service providers exclude the firm, a network firm or other structures or organizations in the network.
- 400.C An audit engagement might involve experts from the firm or network firm, or external experts who assist in the engagement. Depending on the role of the individuals, they might be members of the engagement team or the audit team. For example:
- Individuals with expertise in a specialized area of accounting or auditing who perform audit procedures are members of the engagement team. These include, for example, individuals with expertise in accounting for income taxes or in auditing client information using automated tools and techniques.

- Individuals whose involvement with the engagement is limited to consultation are not members of the engagement team but, depending on the nature of the consultation, might be members of the audit team.
- Individuals who are external experts in fields other than accounting or auditing are not members of the engagement team or the audit team.

400.D If the audit engagement is subject to an engagement quality review, the engagement quality reviewer and any other individuals performing the engagement quality review are not members of the engagement team. Such individuals are members of the audit team.

## SECTION 405

### GROUP AUDITS

#### Introduction

- 405.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.
- 405.2 Section 400 requires a firm to be independent when performing an audit engagement, including a group audit engagement. This section sets out specific requirements and application material relevant to applying the independence provisions in Part 4A to group audits.

#### Requirements and Application Material

##### General

- 405.3 A1 The International Standards on Auditing (ISAs) apply to an audit of group financial statements (group audit). This section addresses the relevant independence considerations that apply in a group audit. ISA 600 (Revised) deals with special considerations that apply to an audit of group financial statements, including when component auditors are involved. ISA 600 (Revised) requires the group engagement partner to confirm whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit. The independence requirements referred to in ISA 600 (Revised) are those specified in this section.

**[Note to IESBA: The definitions shaded in gray below are from proposed ISA 600 (Revised)]**

- 405.3 A2 For purposes of this section:
- Group financial statements are financial statements that include the financial information of more than one entity or business unit through a consolidation process.
  - A group audit is an audit of group financial statements.
  - A group engagement partner is the engagement partner who is responsible for the group audit.
  - A component is an entity or business unit or a function or activity (or some combination thereof) determined by the group auditor for purposes of planning and performing audit procedures in a group audit.
  - A component auditor is an auditor who, at the request of the group auditor, performs audit procedures related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.
  - A group auditor firm is the firm that expresses the opinion on the group financial statements.
  - A group audit client is the entity on whose group financial statements the group auditor firm conducts an audit engagement. The group audit client includes its related entities as specified in paragraph R400.20 and any other components that are subject to audit procedures.
  - A component audit client is:
    - When a component is an entity, the entity and any controlled related entities.

- When a component is a business unit or a function or activity (or some combination thereof), the entity or entities to which the business unit belongs or in which the function or activity is being performed.

Depending on the nature of the component and the audit work requested by the group engagement partner, a component auditor firm might perform an audit of financial statements or an audit of financial information.

- A component auditor firm is the firm carrying out audit procedures on the component at the request of the group auditor firm.
- A group audit team comprises:
  - (a) The engagement team for the group audit, including component auditors;
  - (b) All others within the group auditor firm who can directly influence the outcome of the group audit, including:
    - (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the group engagement partner in connection with the performance of the group audit, including those at all successively senior levels above the group engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent);
    - (ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the group audit; and
    - (iii) Those who perform an engagement quality review, or a review consistent with the objective of an engagement quality review, for the group audit; and
  - (c) All those within a network firm who can directly influence the outcome of the group audit.

#### **Independence Considerations Applicable to Individuals**

**R405.4** All members of the group audit team shall be independent of the group audit client in accordance with the requirements of Part 4A that are applicable to the audit team.

#### **Independence Considerations Applicable to a Group Auditor Firm**

**R405.5** A group auditor firm shall be independent of the group audit client in accordance with the requirements of Part 4A.

#### **Independence Considerations Applicable to Network Firms of a Group Auditor Firm**

**R405.6** A network firm of the group auditor firm shall be independent of the group audit client in accordance with the requirements of Part 4A.

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

##### *All Group Audit Clients*

- R405.7** A component auditor firm outside the group auditor firm's network:
- (a) Shall be independent of the component audit client in accordance with the requirements set out in Part 4A that apply to all audit clients; and
  - (b) Shall not hold a direct or material indirect financial interest in the entity on whose group

financial statements the group auditor firm expresses an opinion.

- 405.8 A1 When a component auditor firm also expresses a separate opinion on the financial statement of a component that is an entity, the requirements of Part 4A apply. For example, when a component auditor firm performs a statutory audit of a component that is a public interest entity and the group to which the component belongs is not a public interest entity, the component auditor firm is required to comply with requirements of Part 4A that apply to public interest entities.
- 405.8 A2 When a component auditor firm outside the group auditor firm's network knows, or has reason to believe, that a relationship or circumstance involving any related entity of the component audit client other than controlled related entities is relevant to the evaluation of the component auditor firm's independence from the component audit client, the application of paragraph R400.20 requires the component auditor firm to include that related entity when identifying, evaluating and addressing threats to independence.
- R405.9** When a component auditor firm outside the group auditor firm's network knows, or has reason to believe, that interests or relationships of a firm within the component auditor firm's network with the component audit client create a threat to the component auditor firm's independence, the component auditor firm shall evaluate and address any such threat.

#### Non-Assurance Services

- 405.10 A1 The financial information on which a component auditor firm performs audit procedures is relevant to the application of Section 600. For example, if the component auditor firm is performing audit procedures only on a specific item such as inventory, non-assurance services unrelated to the accounting records or valuation for inventory would generally not create a self-review threat.

#### *Group Audit Clients that are Public Interest Entities*

- R405.11** When the group audit client is a public interest entity, a component auditor firm outside the group auditor firm's network shall be independent of the component audit client in accordance with the requirements set out in Part 4A that apply to public interest entities.

#### Key Audit Partner

- 405.12 A1 The group engagement partner might determine that the engagement partner on the audit of a component is a key audit partner on the group audit because that individual makes key decisions or judgments on significant matters with respect to the group audit. In these circumstances, once the group engagement partner has communicated that determination to the engagement partner on the audit of the component, that individual will be subject to the provisions in paragraph R411.4, Section 540 and paragraph R524.6 that apply to key audit partners.

#### Proposed consequential amendment to definition of Key Audit Partner:

The engagement partner, the individual responsible for the engagement quality review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, "other audit partners" might include, for example, audit partners responsible for certain components in a group audit context such as significant subsidiaries or divisions.

## Changes in Component Auditor Firms

### *All Group Audit Clients*

- 405.13 A1 There might be circumstances in which the group auditor firm requests another firm to perform audit procedures as a component auditor firm during or after the period covered by the group financial statements. A threat to the component auditor firm's independence might be created by:
- (a) Financial or business relationships of the component auditor firm with the component audit client during or after the period covered by the financial statements but before the component auditor firm agrees to perform the audit procedures; or
  - (b) Previous services provided to the component audit client by the component auditor firm. (Ref: Para R400.31)
- 405.13 A2 Paragraphs 400.31 A1-A2 set out application material relevant to circumstances where threats to independence are created if a non-assurance service was provided to the component audit client during, or after the period covered by the group financial statements, but before the component auditor firm begins to perform the audit of the component, and the service would not be permitted during the engagement period.

## Breach of an Independence Provision by a Component Auditor Firm

- 405.14 A1 ISA 600 (Revised) requires the component auditor firm to take actions when the component auditor concludes that a breach of a relevant ethical requirement applicable to the group audit has occurred. These actions may include promptly communicating the breach to the group engagement partner, including the component auditor firm's assessment of the significance of the breach and any actions proposed or taken to address the consequences of the breach.

### *When a Component Auditor Firm Within the Group Auditor Firm's Network Identifies a Breach*

- 405.14 A2 When the component auditor firm is a network firm of the group auditor firm, paragraphs R400.80 to R400.89 apply.

### *When a Component Auditor Firm Outside the Group Auditor Firm's Network Identifies a Breach*

- R405.15** If a component auditor firm concludes that a breach of a relevant ethical requirement applicable to the group audit has occurred, the component auditor firm shall:
- (a) Comply with paragraph R400.80 (a);
  - (b) Evaluate the significance of the breach and its impact on the component auditor firm's objectivity and ability to express an opinion on the component audit client's financial information for group reporting purposes (Ref: Para 400.80 A2);
  - (c) Depending on the significance of the breach, determine 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; and (Ref: Para 400.80 A3)
  - (d) Promptly communicate the breach to the group engagement partner, including the component auditor firm's assessment of the significance of the breach and any actions proposed or taken to address the consequences of the breach.
- R405.16** Upon receipt of the component auditor firm's communication of the breach, the group engagement partner shall:
- (a) Review the component auditor firm's assessment of the significance of the breach and

any actions proposed or taken to address the consequences of the breach;

- (b) Evaluate the impact of the breach on the group auditor firm's ability to use the work of the component auditor firm for purposes of the group audit; and
- (c) Determine the need for any further action.

**R405.17** In making this determination, the group engagement partner shall exercise professional judgment and take into account whether a reasonable and informed third party would be likely to conclude that the component auditor firm's objectivity would be compromised, and therefore, the group auditor firm is unable to use the work of the component auditor firm for the purposes of the group audit.

405.18 A1 If the group engagement partner determines that the breach has been satisfactorily addressed by the component auditor firm and does not impact the component auditor firm's objectivity, the group auditor firm may continue to use the work of the component auditor for the group audit.

405.18 A2 In all other cases, the nature and extent of action the group auditor firm might take will depend on the group engagement partner's evaluation of the significance and impact of the breach on the component auditor firm's objectivity:

- (a) In some circumstances, the group auditor firm might determine that actions can be taken to allow the group auditor firm to use the component auditor firm's work. Examples of such action include the group auditor firm performing specific procedures on the areas impacted by the breach or requesting the component auditor firm to perform appropriate remedial work on the affected areas; or
- (b) In other circumstances, the group auditor firm might determine that it cannot use the component auditor firm's work. In such situations, the group auditor firm might need to take further action to obtain the necessary audit evidence on the component audit client's financial information. Examples of such action include requesting the group audit client to arrange for another component auditor firm to be engaged to perform the audit procedures on the component audit client's financial information, or the group auditor firm carrying out the necessary audit procedures on the component audit client's financial information.

*Communication with Those Charged with Governance of the Group Audit Client*

**R405.19** Unless already addressed by a process pre-agreed with those charged with governance, the group auditor firm shall discuss with those charged with governance as soon as possible:

- (a) The significance of the breach at the component auditor firm, including its nature and duration;
- (b) Whether the action proposed or taken would satisfactorily address the consequences of the breach and enable the group auditor firm to issue the audit report on the group financial statements;
- (c) The group auditor firm's conclusion as to whether the objectivity of the component auditor firm has been compromised and the rationale for that conclusion.

**R405.20** If those charged with governance do not concur that the actions proposed or taken by the component auditor firm satisfactorily address the consequences of the breach at the component auditor firm, the group auditor firm shall:

- (a) Not use the work performed by the component auditor firm for the purposes of the group audit; and

- (b)** Determine whether to perform further or alternative procedures, or perform itself the necessary audit procedures on the component audit client, to obtain such concurrence.