

Project Proposal

Independence: Engagement Team – Group Audits (March 2020)

I. Subject

1. Revisions to the [International Code of Ethics for Professional Accountants \(including International Independence Standards\)](#) (the Code) to address engagement team – group audits independence considerations.

II. Background and Relevant Developments

IESBA Strategy Consultation

2. During the IESBA’s consultation on its [Strategy and Work Plan 2019-2023](#) (SWP), many respondents expressly supported an enhanced level of strategic and technical coordination with other standard-setting Boards (SSBs), particularly the International Auditing and Assurance Standards Board (IAASB), with transparency provided about the work and status of such efforts.
3. Among the responses to the SWP consultation paper, there was also an encouragement for the IESBA to consider a project to address practical issues encountered by group and component auditors in applying the independence standards in the audit of group financial statements. The IESBA determined that it would be appropriate to explore the need for clarifications in this area, but to do so in coordination with the IAASB’s project to revise its group audits standard (International Standard on Auditing (ISA) 600).¹

Developments Pertaining to the IAASB’s Agenda

Revision of ISA 220²

4. Respondents to the IAASB’s December 2015 [Invitation to Comment](#) (ITC), *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* were supportive of a project to modernize ISA 220. As a result, the IAASB issued the exposure draft [Proposed ISA 220 \(Revised\)](#) (ED-220) in February 2019.³ Amongst other matters, ED-220 proposed changing the definition of an engagement team⁴ as follows to recognize different and evolving engagement team structures, thereby addressing the concerns identified in the ITC and the project proposal:

Engagement team – All partners and staff performing the audit engagement, and any individuals who perform audit procedures on the engagement, including individuals engaged by the firm or a network firm.⁵ ~~who perform audit procedures on the engagement. This~~ The engagement team excludes an auditor’s external expert engaged by the firm or a network firm. ~~The term “engagement team” and also~~

¹ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

² ISA 220, *Quality Control for an Audit of Financial Statements*

³ The IAASB plans to finalize ISA 220 (Revised) in June 2020,

⁴ ED-220 (Revised), paragraph 10(d)

⁵ ISA 620, *Using the Work of an Auditor’s Expert*, paragraph 6(a), defines the term “auditor’s expert.”

excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).⁶

5. In proposing this definitional change, the IAASB took into account that engagement teams may be organized in a variety of ways, including being located together or across different geographic locations, or organized by the activity they are performing. The IAASB also recognized that individuals who are involved in the audit engagement may not necessarily be engaged or employed directly by the firm. Thus, the IAASB proposed that, regardless of their location or employment status, if individuals are performing audit procedures on the engagement, they are part of the engagement team. In this way, their work can be appropriately directed, supervised and reviewed according to the requirements of ISA 220 (Revised).
6. Given that ED-220 is intended to apply to all audits of financial statements, including audits of group financial statements (group audits), the definitional change leads to the inclusion of component auditors⁷ (whether in or outside the group auditor’s firm or network) in the engagement team for a group audit because they are performing audit procedures for purposes of the group audit. This has implications with respect to the application of the independence requirements in the International Independence Standards (IIS) in Part 4A⁸ of the Code, as further described below.

Revision of ISA 600

7. Based on responses to the ITC and other input gathered during related outreach activities as well as discussions with the IAASB Consultative Advisory Group (CAG), the IAASB approved a [project proposal](#) to revise ISA 600 in December 2016. In its September 2017 [project update](#), the IAASB noted that some foundational issues to be dealt with in the revisions to ISA 600 need to be first considered and addressed in projects to revise other standards, in particular International Standard on Quality Control (ISQC) 1,⁹ ISA 220, and ISA 315 (Revised).¹⁰ Since then, with the progress made on these other projects, the IAASB has advanced the revision of ISA 600, with an Exposure Draft anticipated for approval in March 2020.
8. A key aspect of extant ISA 600 that intersects with the IIS is the requirement for the group engagement team to obtain an understanding of whether a component auditor understands and will comply with the ethical requirements that are relevant to the group audit.¹¹ Some stakeholders, including firms, have highlighted the need to clarify the meaning of the phrase “ethical requirements that are relevant to the group audit.” This concept is not currently addressed in the Code but will need

⁶ ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

⁷ ISA 600 defines a “component auditor” as “an auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit.”

⁸ Part 4A of the IESBA Code - Independence for Audit and Review Engagements

⁹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

¹⁰ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

¹¹ ISA 600, paragraph 19(a)

to be developed.

The Interaction Between ISAs 220 and 600

9. ED-220 is designed to operate (a) as part of the broader system of quality management established by the IAASB's proposed Quality Management standards at both the firm and engagement levels,¹² and (b) in conjunction with ISA 600. Revisions to ISA 220 were made in response to stakeholder feedback on the ITC. In particular, some stakeholders had requested that the IAASB more clearly articulate the linkage between ISAs 220 and 600. There also was a view that it would be necessary to consider how the definition of "group engagement team" relates to the definition of "engagement team" in ISA 220.
10. Respondents also requested clarification as to which engagement participants fall within or outside the definitions of "group engagement team" and "component auditor" given different and evolving team structures.
11. Depending on the nature and extent of revisions to the concepts of engagement team, group engagement team and component auditor in proposed ISAs 220 (Revised) and 600 (Revised) and the interactions of these concepts, there may be implications with respect to the application of the independence requirements that may need to be addressed in the IIS.

Implications of Proposed Revised Definition of Engagement Team for the Code and Related IAASB-IESBA Coordination

12. Many respondents to ED-220 commented on the change to the definition of engagement team. In considering the interactions of the proposed revised definition with relevant ethical requirements, some raised practical concerns related to alignment with the independence requirements in the Code. Respondents highlighted the need for coordination between the IAASB and IESBA in this regard.
13. The definition of engagement team in the Code was developed based on the engagement team definition in extant ISA 220. While the IAASB intended to change the definition in ISA 220 for quality management purposes, the inclusion of component auditors in the revised definition raises a number of questions with respect to compliance with the IIS in the context of group audits, given that the definitions of the term in the Code and the ISAs are the same.
14. In particular, the change in definition introduces new categories of individuals to be subject to specific independence requirements. When the relevant provisions of the Code were developed based on the extant definition, the independence requirements applicable to those individuals were not considered. There is therefore a need to understand who those individuals are and confirm or develop applicable independence requirements, taking into account their roles in the audit engagement and specific facts and circumstances. This review would need to maintain consistency with the existing provisions of the IIS for members of the engagement team as currently defined in the Code, having regard to the need for global operability.
15. In the light of the above and following coordination with the IAASB on the ISA 220 project, the IESBA agreed to address the implications of the change in the definition of engagement team from the Code's perspective with a view to making clear the independence requirements that apply to the various individuals who are part of the engagement team under the revised definition.. The IAASB in

¹² See <https://www.iaasb.org/news-events/2019-02/global-consultation-quality-management-firms-and-engagements-now-open>

turn agreed to make clear in proposed ISA 220 (Revised) that the independence requirements applicable to members of the engagement team are specified in relevant ethical requirements which, as defined in proposed ISA 220 (Revised), include the Code.

Independence of Component Auditors in the Context of a Group Audit

16. In view of the fact that component auditors outside a firm’s network are now included within the engagement team under the proposed revised definition, in the context of group audits performed in accordance with ISA 600 it is necessary to ensure that the IIS provide clear and consistent guidance with respect to independence for component auditors outside the network. Specifically, there is a need to go beyond individuals included in the engagement team definition and consider the independence framework applicable to the component auditor firms given that proposed ISA 600 (Revised) establishes a requirement for the group engagement partner to take responsibility for obtaining confirmation from component auditors that ethical requirements relevant to the group audit engagement, including those related to independence, have been fulfilled.

Matters Identified by the Emerging Issues and Outreach Committee (EIOC)

17. As part of its monitoring of the external environment for emerging issues or developments, the EIOC has identified a few questions relating to the application of the independence requirements with respect to component auditors. These include the following:
- The implications when a parent entity is a public interest entity (PIE) but a component is not and that component is audited by a non-network firm, in particular whether the component auditor would need to follow the independence requirements that apply to PIEs or non-PIEs. The Code does not currently address this.
 - The practical implications when there is a breach of independence at a component auditor and how it was remediated if the group auditor still intends to use the work of the component auditor (separately from the group auditor’s consideration in accordance with ISA 600).¹³

III. Project Objectives, Focus, Scope and Approach

Project Objectives, Focus and Scope

18. The objectives of the project are two-fold:
- (a) To align the definition of the term “engagement team” in the Code with the revised definition of the same term in proposed ISA 220 (Revised) while ensuring that the independence requirements in the IIS are clear and appropriate and apply only to those individuals within the scope of the revised definition who must be independent in the context of the particular audit engagement; and
 - (b) To revise the IIS so that they are robust, comprehensive and clear when applied in a group audit context, including with respect to independence for non-network component auditors.

¹³ From an audit perspective, extant ISA 600, paragraph 20, states the following: “If a component auditor does not meet the independence requirements that are relevant to the group audit, or the group engagement team has serious concerns about the other matters listed in paragraph 19(a)–(c), the group engagement team shall obtain sufficient appropriate audit evidence relating to the financial information of the component without requesting that component auditor to perform work on the financial information of that component.”

19. The project is focused on audits of financial statements and auditor independence (Part 4A of the Code). The implications for Part 4B of the Code (other assurance engagements) will be taken into account and addressed as necessary.
20. In relation to the analysis of the issues and consideration of revisions by the IESBA, the scope will encompass:
 - (a) The IIS in Part 4A; and
 - (b) Any consequential or conforming changes deemed necessary to the IIS in Part 4B and any other sections of the Code.

Project Approach

21. With respect to the IAASB's proposed revised definition of engagement team, the project will take the following approach:
 - (a) Develop a revised definition of the same term in the Code aligned with the IAASB's proposed definition.
 - (b) Identify the implications of the revised definition on the relevant independence provisions in Part 4A.
 - (c) Consider how best to address those implications to ensure that the IIS provide clear and consistent guidance with respect to independence for the various parties within the scope of the revised definition, especially in a group audit context. In this regard, consideration will be given to current practices followed by networks and how the conceptual framework has been applied by firms and regulators in addressing the relevant independence matters.
 - (d) Develop options for addressing the implications as appropriate.
 - (e) Present recommendations for the IESBA's consideration.
 - (f) Develop the appropriate revisions to the IIS.
22. With respect to enhancing and clarifying the application of the IIS in a group audit context, the project will address the following matters:
 - (a) The meaning of the phrase "ethical requirements that are relevant to the group audit" in paragraph 19(a) of extant ISA 600 in the context of the IIS. In doing so, consideration will be given to:
 - The various scenarios that may arise in practice; for example, when a parent entity is a PIE but a component is not and that component is audited by a non-network firm, whether the component auditor should follow the independence requirements that apply to PIEs or non-PIEs.
 - Based on that analysis, how the relevant requirements should be applied at the component level.
 - The application of the related entity provision in paragraph R400.20 of the Code in these scenarios.

- (b) The implications of a breach of independence by a component auditor in the context of a group audit, including communication expectations with respect to the group engagement team and those charged with governance of the group.
23. Coordination with the IAASB will be an integral part of the project, especially in relation to the IAASB's projects to revise ISAs 220 and 600. The established principles of IAASB-IESBA coordination will apply.
24. The project will involve consultations with various stakeholders at appropriate points over the course of the project, including:
- Regulators and audit oversight bodies
 - Firms
 - Those Charged with Governance and the Investor community
 - The IESBA CAG
 - National standard setters
 - Professional accountancy organizations in major jurisdictions

IV. How the Project Serves the Public Interest and Impact Analysis

How the Project Serves the Public Interest

25. The public interest will be served by:
- (a) Having aligned definitions of the term “engagement team” in the Code and IAASB standards while retaining appropriate specificity and proportionality for the IIS consistent with a principles-based Code; and
 - (b) Enhancing the robustness and clarity of the IIS for application in any group audit situation.

Impact Analysis Considerations

26. As the project advances, costs and benefits will be an important consideration as the IESBA evaluates options and the practical impact of any potential changes to the Code. The nature and extent of those costs and benefits will depend on the nature and extent of the changes envisaged.
27. The IESBA will be especially mindful of any potential increased complexity in the Code, which may undermine understandability and clarity.

V. Implications for any Specific Persons or Groups

28. The project has implications for:
- National standard setters that have adopted the Code or use it as a basis or a benchmark for their ethics and independence standards.
 - Firms that have conformed their policies and methodologies to the Code for transnational audits or are otherwise subject to national standards based on the Code.
 - Preparers and those charged with governance in relation to their interactions with group auditors on independence and audit matters.

- The regulatory and audit oversight community in relation to enforcement of independence and quality management requirements.

VI. Development Process, Project Output and Project Timetable

Development Process

29. The project will follow the IESBA's due process, including seeking input and advice from the IESBA CAG.

Project Output

30. It is anticipated that the output of the project will include:
- A revised definition of the term “engagement team” in the Code
 - Revisions or new provisions to the IIS in Part 4A.
 - Any consequential or conforming amendments to the IIS in Part 4B and to other sections of the Code.
31. Depending on issues identified, the Task Force may also identify other relevant matters for the IESBA's consideration.

Project Timetable

32. Subject to the IESBA's approval of the project proposal, this project will commence immediately. The specific project milestones and outputs will be dependent on the matters that the project Task Force ultimately determines are appropriate to address as part of the project, and the priorities assigned to those matters.
33. The table below provides indicative timing for the project up to and including approval of an Exposure Draft.

Indicative Timing	Milestone
March 2020	• CAG consideration of project proposal
	• IESBA consideration and approval of project proposal
June 2020	• IESBA: Discussion of issues
September 2020	<ul style="list-style-type: none"> • CAG: Discussion of proposed changes to the IESBA Code • IESBA: First read of proposed changes
December 2020	• IESBA approval of exposure draft

VII. Resources Required

34. A project Task Force consisting of four individuals, led by the former IESBA liaison to the IAASB, Sylvie Soulier, at least until the Exposure Draft stage.

35. IESBA Staff will provide support to the project Task Force.

VIII. Relevant Sources of Information that Address the Matters Being Proposed

36. Relevant sources of information include:

- The large networks of firms that perform transnational audits in terms of (a) practical issues they have encountered in applying the independence requirements of the Code, and (b) the policies or best practices they have followed.
- Approaches to independence requirements taken by national standard setters that have not adopted, or otherwise based their independence standards on, the Code.
- Drafts of ISA 220 (Revised) and ISA 600 (Revised) as they evolve and are finalized.

Appendix

Comments by Standard-Setting Board (SSB)/IFAC Technical Managers

Due process requires that project proposals be circulated to SSB Staff and IFAC Staff for the technical areas within, or supported by, IFAC for comments on any matters of possible relevance to the project.

Senior Staff to the IFAC Quality and Development Department

As primary contacts with PAOs through the Member Compliance Program, we note that in jurisdictions where a) the national standard-setter and/or PAO has to translate the standards for adoption and implementation or b) the national standard/setter and/or PAO has limited means to address and align changes within its own Code on a timely basis, this might impact global adoption and implementation of any changes.

No additional significant concerns or comments related to this project proposal.

We encourage the IESBA to update, issue, and if feasible translate, guidance for the changes

Signed: Sarah Gagnon

Date: February 28, 2020

Senior Staff to the IFAC Education Initiative

No comments.

Signed:

Date: March 11, 2020

Senior Staff to International Auditing and Assurance Standards Board (IAASB)

N/A – Coordination with the IAASB will be an integral part of the project, especially in relation to the IAASB's projects to revise ISAs 220 and 600. The established principles of IAASB-IESBA coordination will apply.

Senior Staff to the IFAC Professional Accountants in Business (PAIB) Committee

No comments.

Signed: Laura Leka

Date: February 24, 2020

Senior Staff to the International Public Sector Accounting Standards Board (IPSASB)

No comments.

Signed:

Date: March 11, 2020

Senior Staff to the IFAC Small and Medium Practices (SMP) Committee

I support the coordination by the IAASB and IESBA on the revised definition of an engagement team. The IFAC SMP Committee (SMPC) response to the IAASB Exposure Draft for proposed ISA 220 (Revised) raised concerns about the change for all component auditors to be included in the revised definition and the consequences in terms of the independence requirements. Close coordination between the Boards is therefore critical to avoid inconsistency in application and unnecessary market confusion. It is also important the changes can operationalize for firms of all sizes and do not have a disproportionate impact on small- and medium sized practices (SMPs). I look forward to facilitating input from the SMPC as the project progresses.

Signed: Chris Arnold

Date: March 3, 2020

Senior Staff to the Transnational Auditors Committee (TAC)

No comments.

Signed:

Date: March 11, 2020