



Agenda Item
7

**Engagement Team - Group Audits
Independence**

Sylvie Soulier, Task Force Chair

IESBA Board Meeting
Virtual
June 8- 15 2020

Objectives of the Session



To discuss the Task Force's observations based on its information gathering to date



To provide feedback on the Task Force's preliminary views, proposed approach to addressing the relevant issues, and other identified matters

Agenda of the Session



BACKGROUND



**DEFINITION OF
ENGAGEMENT
TEAM**



**INDEPENDENCE
FOR COMPONENT
AUDITORS IN THE
CONTEXT OF
GROUP AUDIT**



**FURTHER
MATTERS TO
BE
ADDRESSED**



**TASK FORCE
NEXT STEPS**



Background

Project Objective, Focus and Scope

- 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)
 - To consider independence provisions that should apply to those individuals
- Independence for component auditors in the context of Group Audit (ISA 600 (Revised))
 - Focus is on audits of f/s and auditor independence (i.e., Part 4A)
- Implications for Part 4B to be considered and addressed



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2nd bullet: It is referring to both network and non-network Component Auditors in Group Audit

Definition of Engagement Team (Extant Code versus Proposed ISA 220 (Revised))

Extant Code	Proposed ISA 220 (Revised)
<p>All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm.</p> <p>The term “engagement team” also 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), <i>Using the Work of Internal Auditors</i>.</p>	<p>All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, excluding an auditor’s external expert engaged by the firm or a network firm, and internal auditors who provide direct assistance on an engagement. (Ref: Para. A16–A25)</p> <p>A18 Engagement teams include individuals from the firm who perform audit procedures and may include individuals who perform audit procedures from:</p> <ul style="list-style-type: none"> a) A network firm b) A firm that is not a network firm c) A service provider. <p>For example, an individual from a network firm or from a firm that is not a network firm, may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count or inspect physical fixed assets at a remote location.</p>

The definition of ET in the extant Code is based on extant ISA 220:

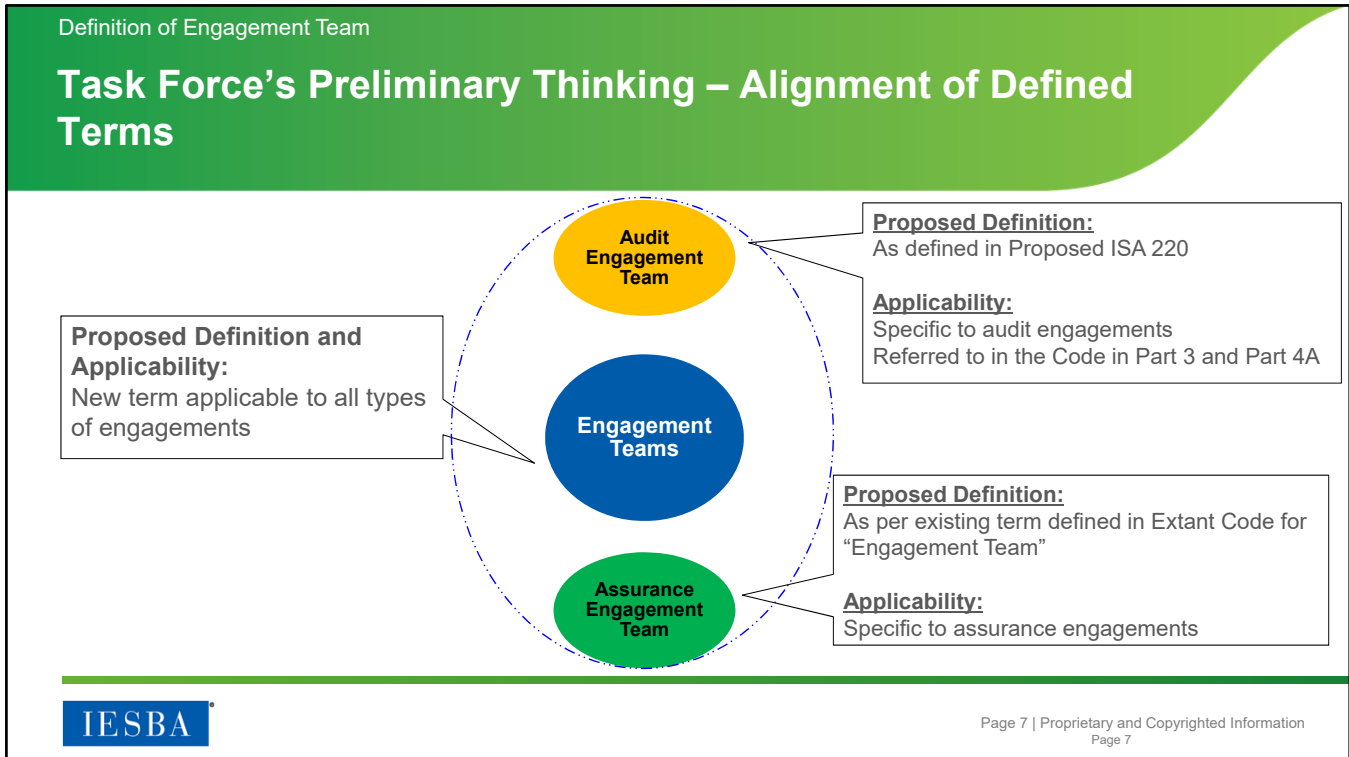
All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform audit procedures on the engagement. This excludes an auditor’s external expert engaged by the firm or a network firm.

In the extant Code, we introduced the terms “assurance procedures” rather than referring to audit procedures. In the revised definition, it specifically refers to audit engagements performing the audit procedures.

Observations on the Extant Code

The IIS are written to address standalone engagements only:

- The extant Code's definition of ET is based on extant ISA 220, but applies to both audit and assurance engagements
 - ISA 220 applies only to audit engagements
 - Refers to single engagement (audit or assurance), defines the "Audit Client" which includes Related Entities (R400.20)
- The extant Code definition is silent on independence of individuals that are not engaged by the firm or network firm (e.g. non-network component auditors)
- Changing the definition of ET affects other definitions - "audit team" and "assurance team"
- The extant Code also refers to "Engagement Team" for non-assurance engagements (e.g. Conflicts of Interest)



Definition of ET in extant Code:

All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm.

The term "engagement team" also 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), *Using the Work of Internal Auditors*.

Matters for IESBA Consideration: Alignment of Defined Terms

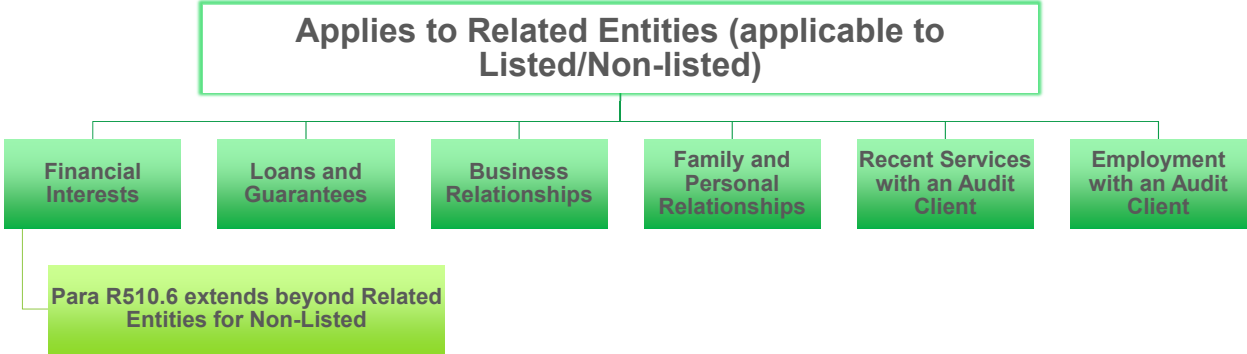


Views on, or reactions to, the
Task Force's preliminary thinking



Whether members has any
other comments

Independence provisions for ET in extant Code



The above are looking at threats and safeguards that is in the extant Code

Question for consideration: Do we intend to apply the same requirements to ET member both inside and outside the network?


Definition of Engagement Team

Independence provisions for new members of ET (Revised Definition)

ET members from network and non-network CA and service provider



 Under the Conceptual Framework, does it make sense to apply same provisions for network and non-network firm ET members?

If non network ET member only works at the component level, from which related entities should that individual be independent? 



Question for consideration: Do we intend to apply the same requirements to ET member both inside and outside the network?

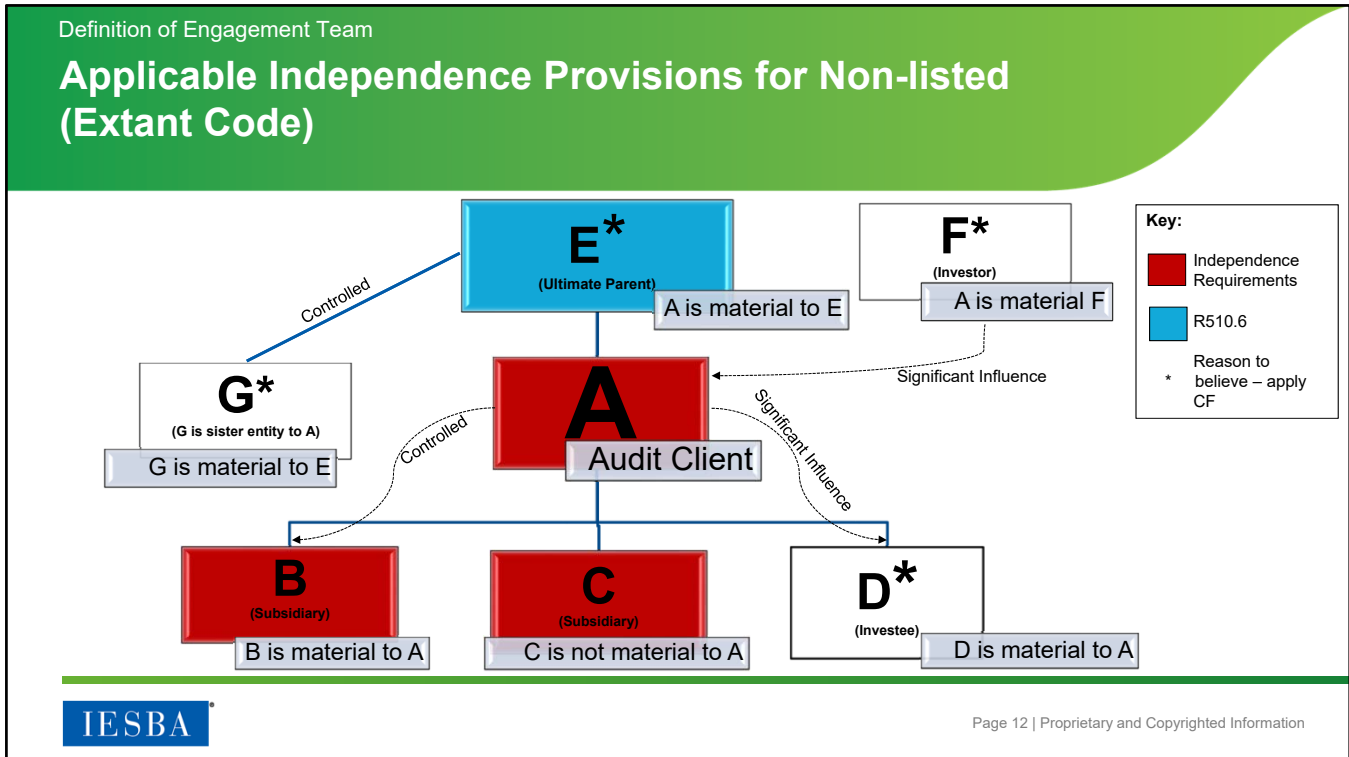
Related Entity Definition

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.

Financial Interests in an Entity Controlling an Audit Client

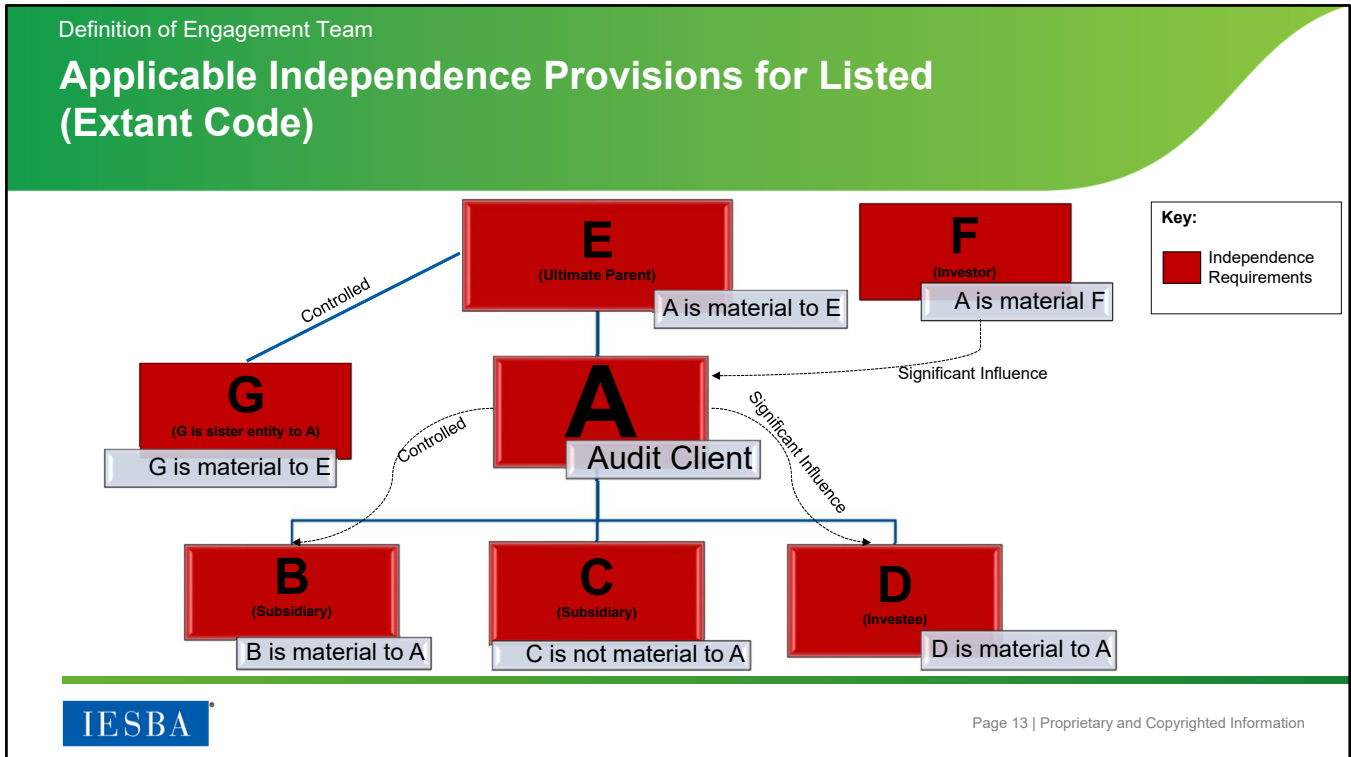
R510.6 When an entity has a controlling interest in an audit client and the client is material to the entity, neither the firm, nor a network firm, nor an audit team member, nor any of that individual’s immediate family shall hold a direct or material indirect financial interest in that entity.



This slide explains the team which has to be independent in the the audit of A which is a non-listed entity:

- A Is the audit client so the independence requirements applies
- B Controlled subsidiary to A so the independence requirements applies
- C Not material to A though the independence requirements applies
- D A has significant influence on D
- E Ultimate parent of which A is material to E hence requirements from R510.6 applies
- F F has financial interest in A as investor and A is material to F
- G G is material to E

For D,E,F,G, if the above scenario holds true, then apply the CF



This slide explains the team which has to be independent in the audit of A which is a listed entity – so independence requirements applies to all

Task Force Preliminary Views – Component Auditors (Network and Non-Network)

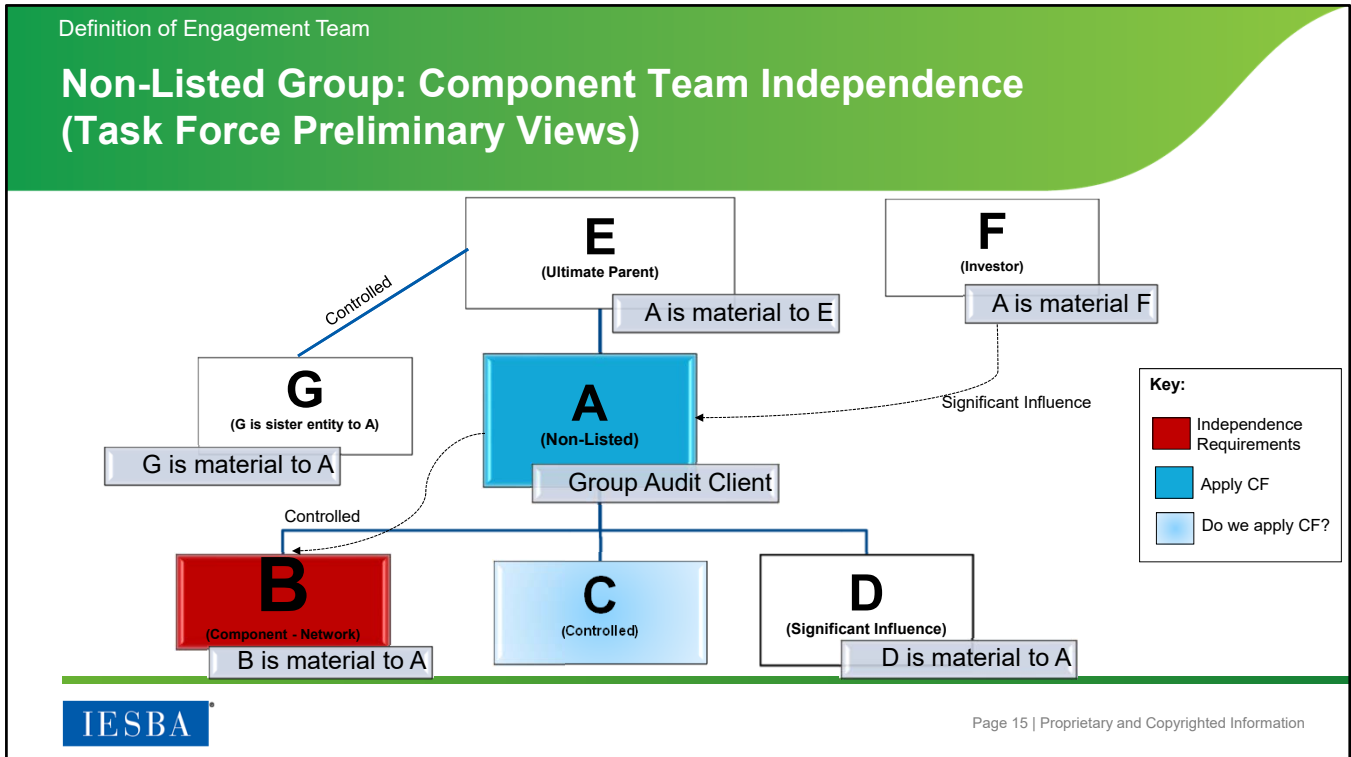
Concept of Component is not based on its legal provisions or structure

**CAs from the same Network
(Individuals)**

- Same independence requirements applicable to the Group Team applies to individuals of CA from same network

**CAs from Non-Network
(Individuals)**

- Must be independent of the component and the entities downstream
- If Component is material to Group Parent, then the independence requirements will extend up those entities

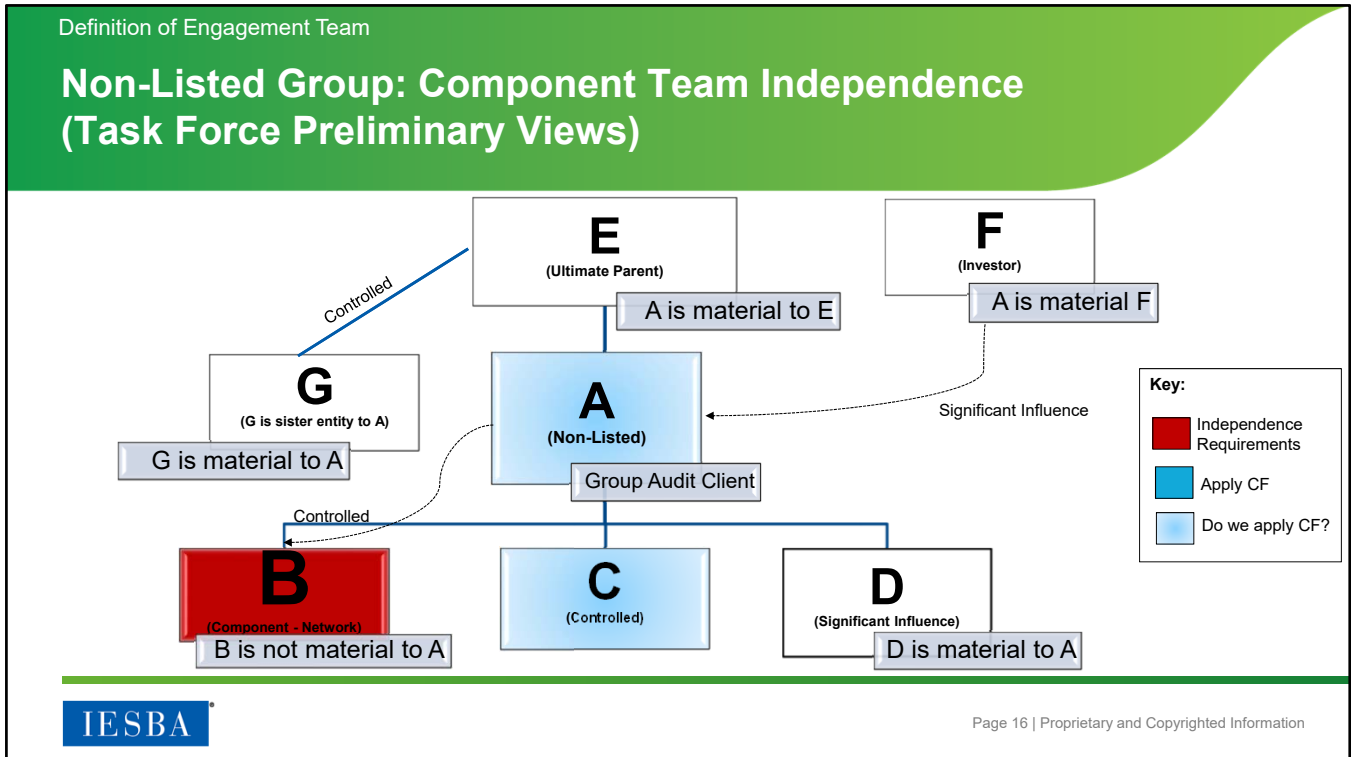


B is the entity in focus

- so the independence requirements applies to individuals auditing B
- B is MATERIAL to A, the Group Audit Client (Non-Listed)
- As B is audited by component auditor within the network, the CF applies to the individuals auditing A

Proposal:

As C is controlled entity for A, should we apply the CF to individuals auditing C?

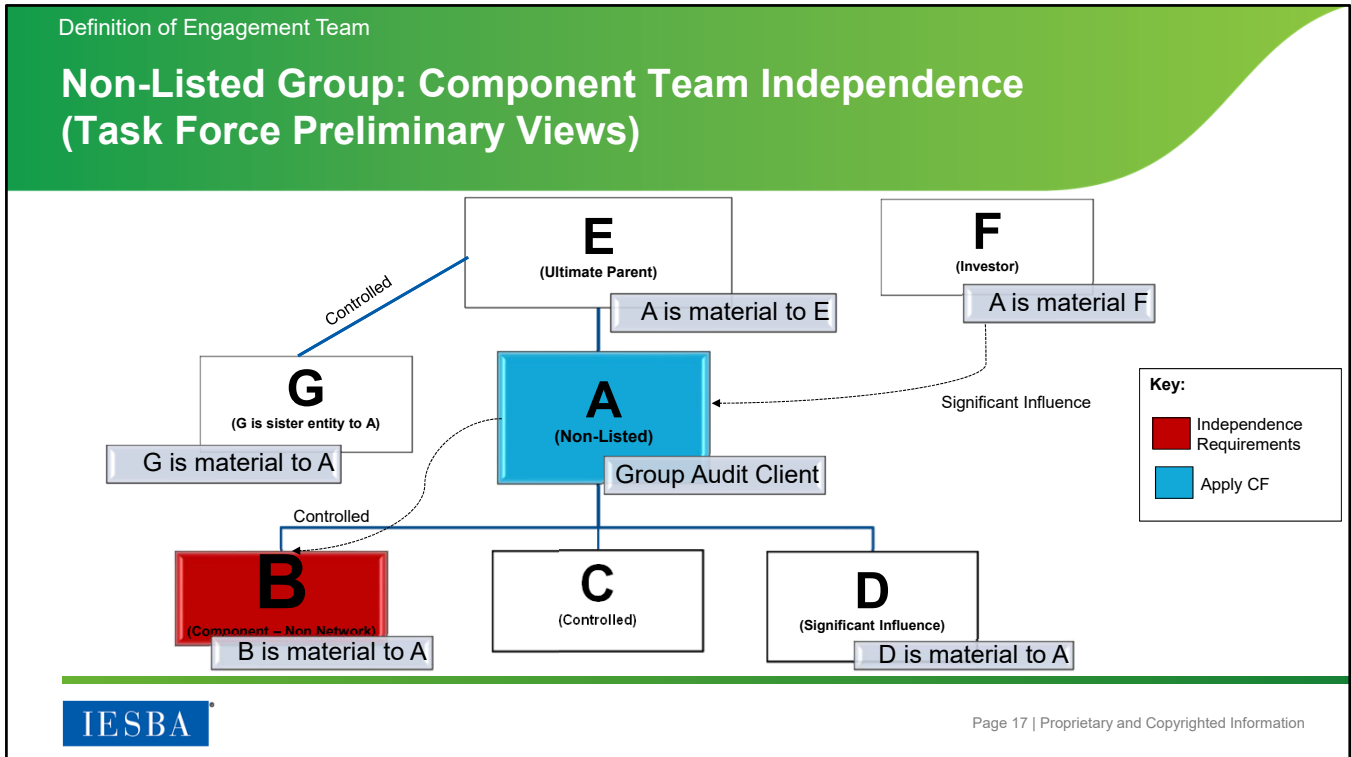


B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is IMMATERIAL to A, the Group Audit Client (Non-Listed)
- B is audited by component auditor within the network

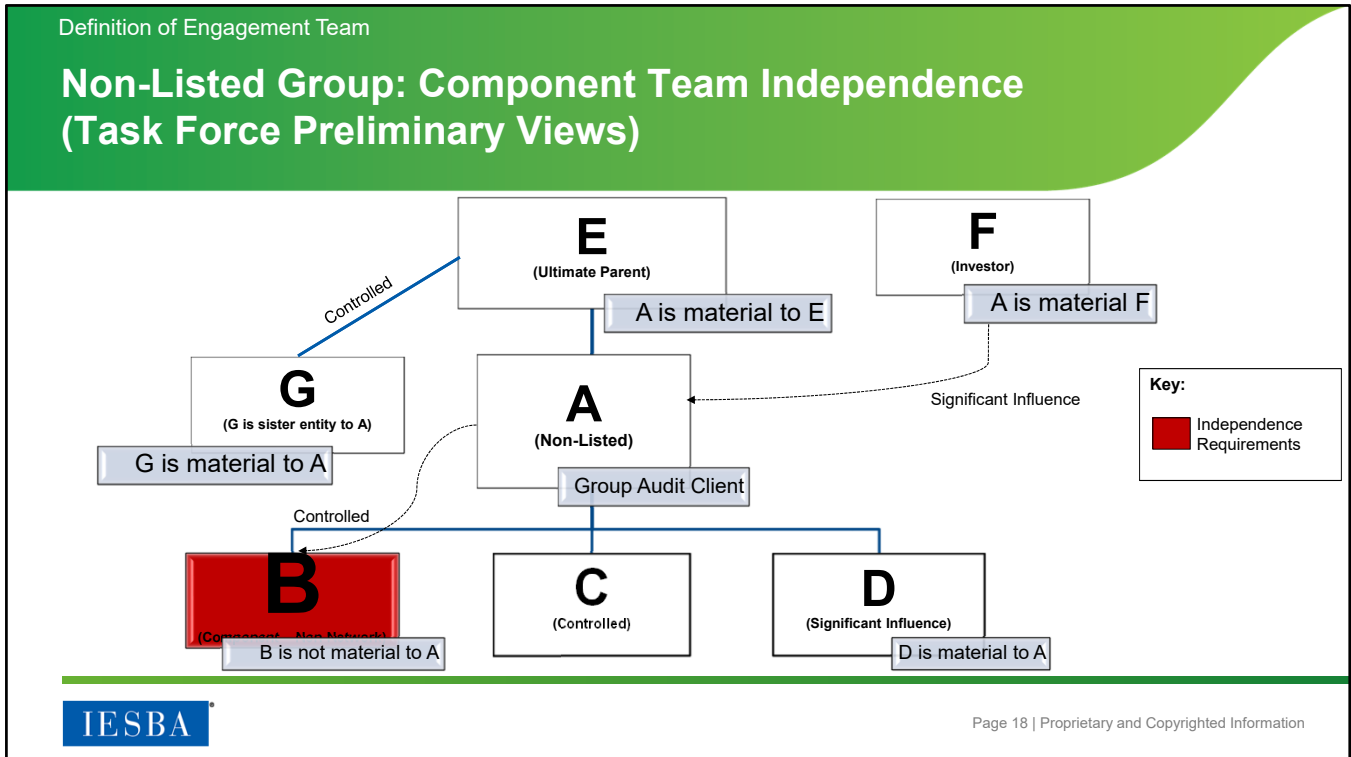
Proposal:

- As B is an immaterial entity (to A, the Group Audit Client (Non-Listed)) audited by component auditor within the network, should the CF apply to the individuals auditing A?
- As C is controlled entity for A, should we apply the CF to individuals auditing C?



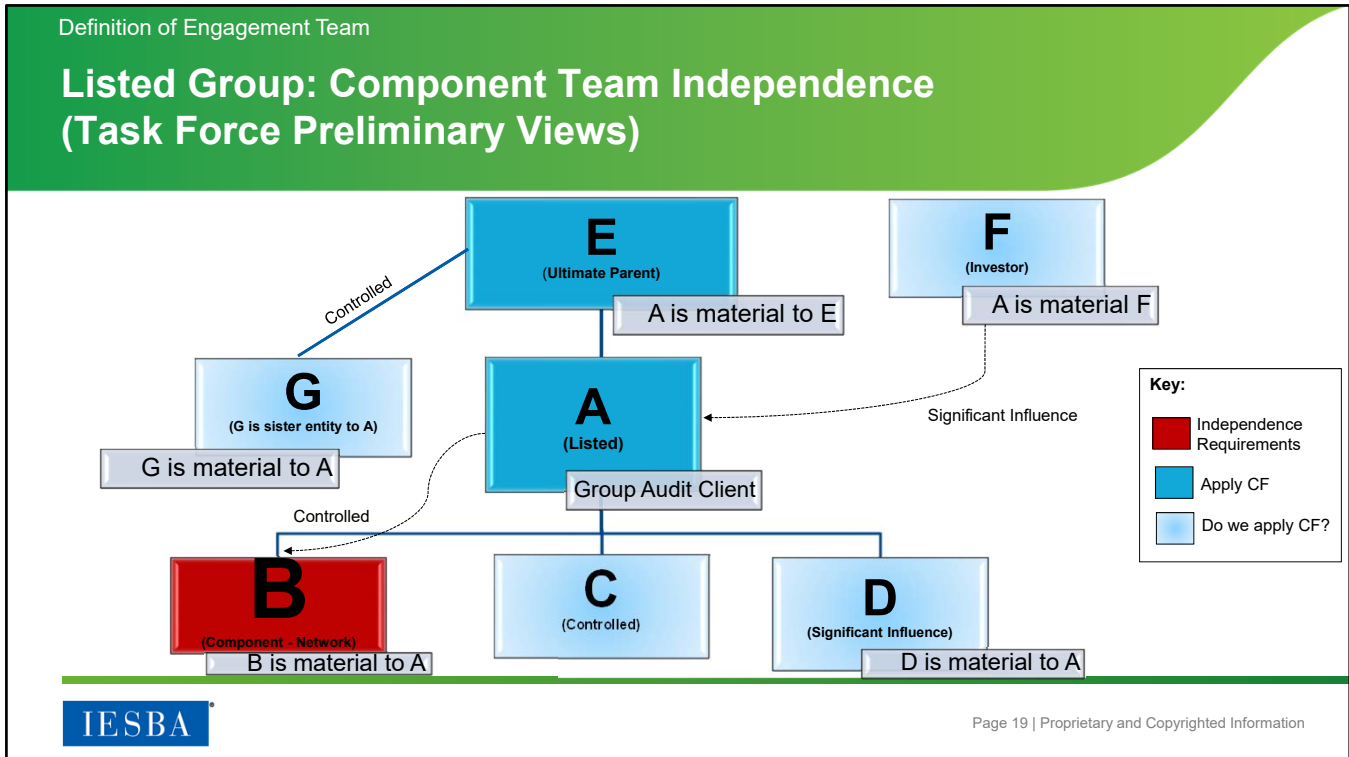
B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is MATERIAL to A, the Group Audit Client (Non-Listed)
- B is audited by component auditor outside of the network, so the CF applies to the individuals auditing A



B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is IMMATERIAL to A, the Group Audit Client (Non-Listed)
- B is audited by component auditor outside of the network
- B is not material to A and audited by component auditor outside of the network so no other provisions apply

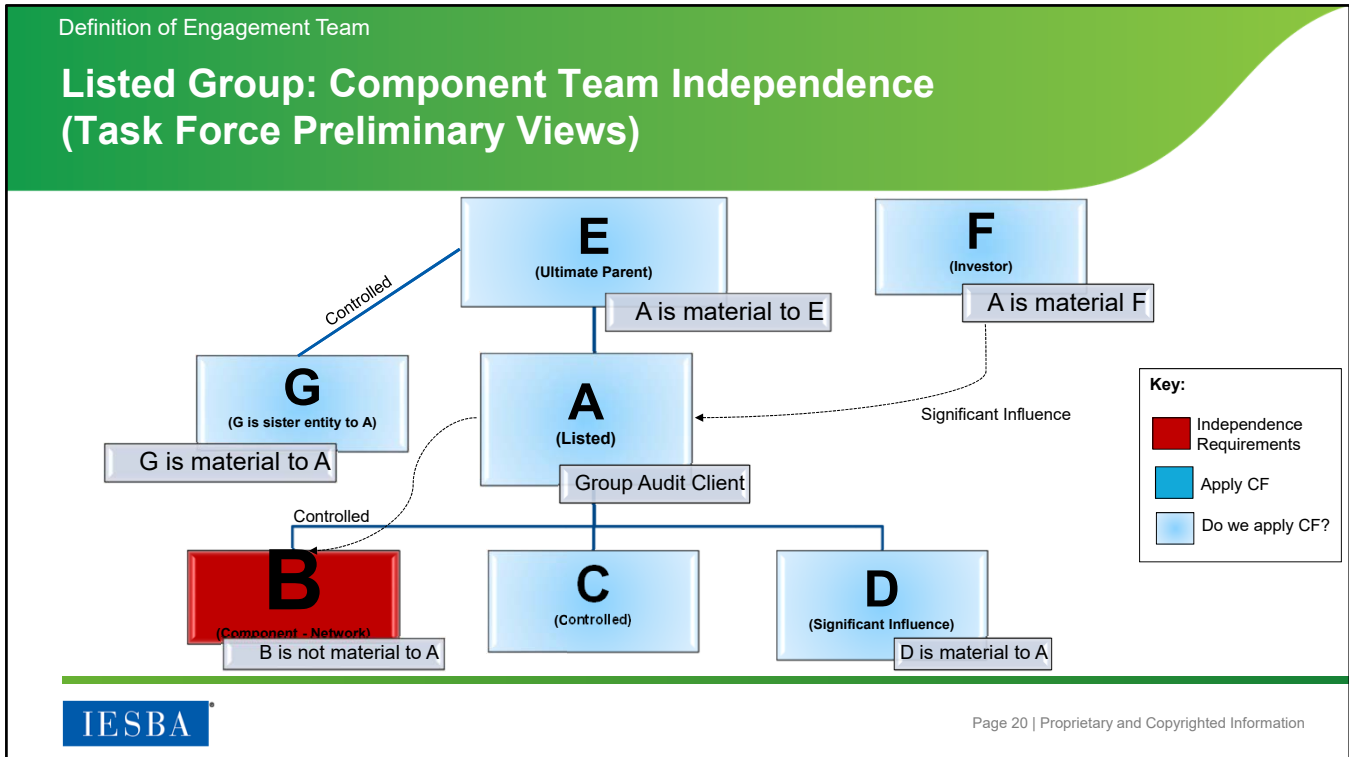


B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is MATERIAL to A, the Group Audit Client (Listed)
- As B is material and audited by component auditor within the network, CF is applied upstream (A and E)

Proposal:

- As it is a material entity (to A, the Group Audit Client (Non-Listed)) audited by component auditor within the network, should the CF apply to the individuals auditing the related entities within the Group (C, D, F and G)?

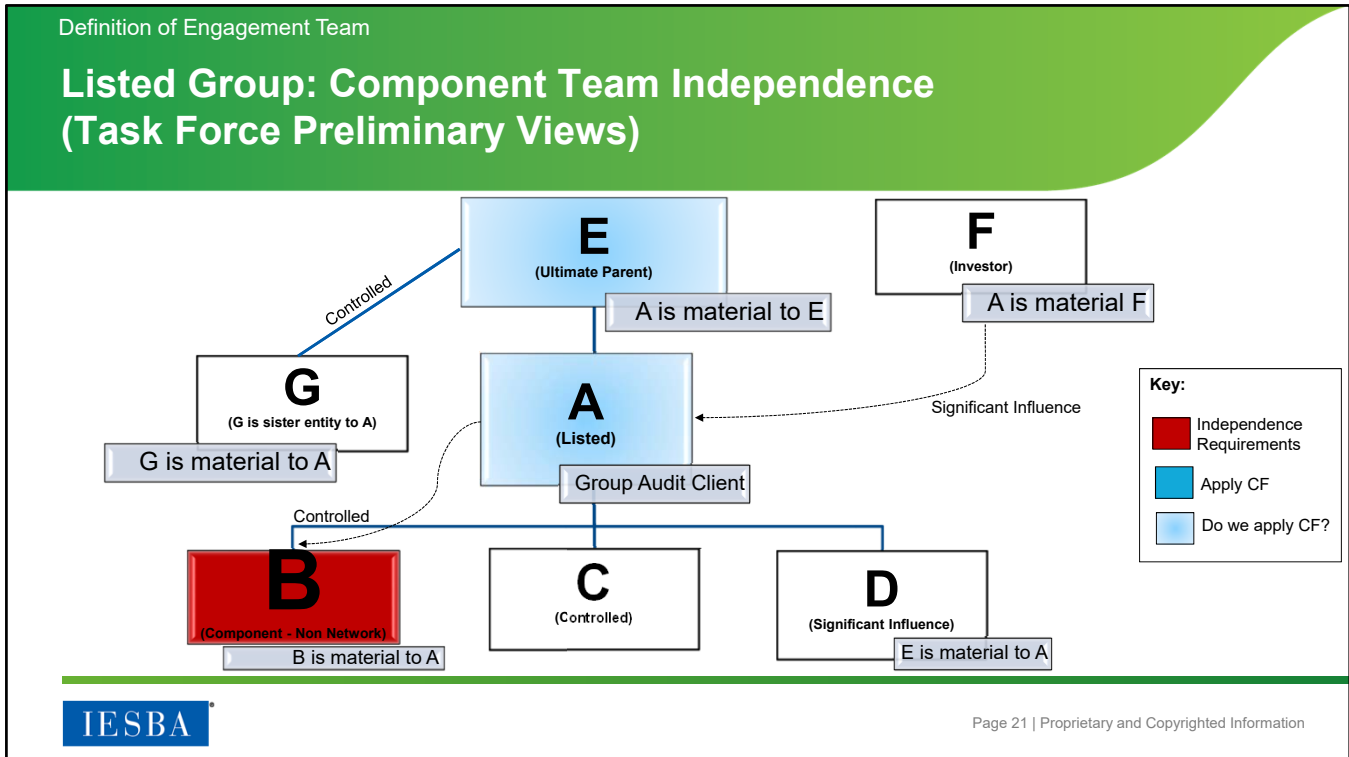


B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is IMMATERIAL to A, the Group Audit Client (Listed)
- B is audited by component auditor within the network

Proposal:

- As it is an immaterial entity (to A, the Group Audit Client (Non-Listed)) audited by component auditor within the network, should the CF apply to the individuals auditing the related entities within the Group (A, C, D, E, F and G)?

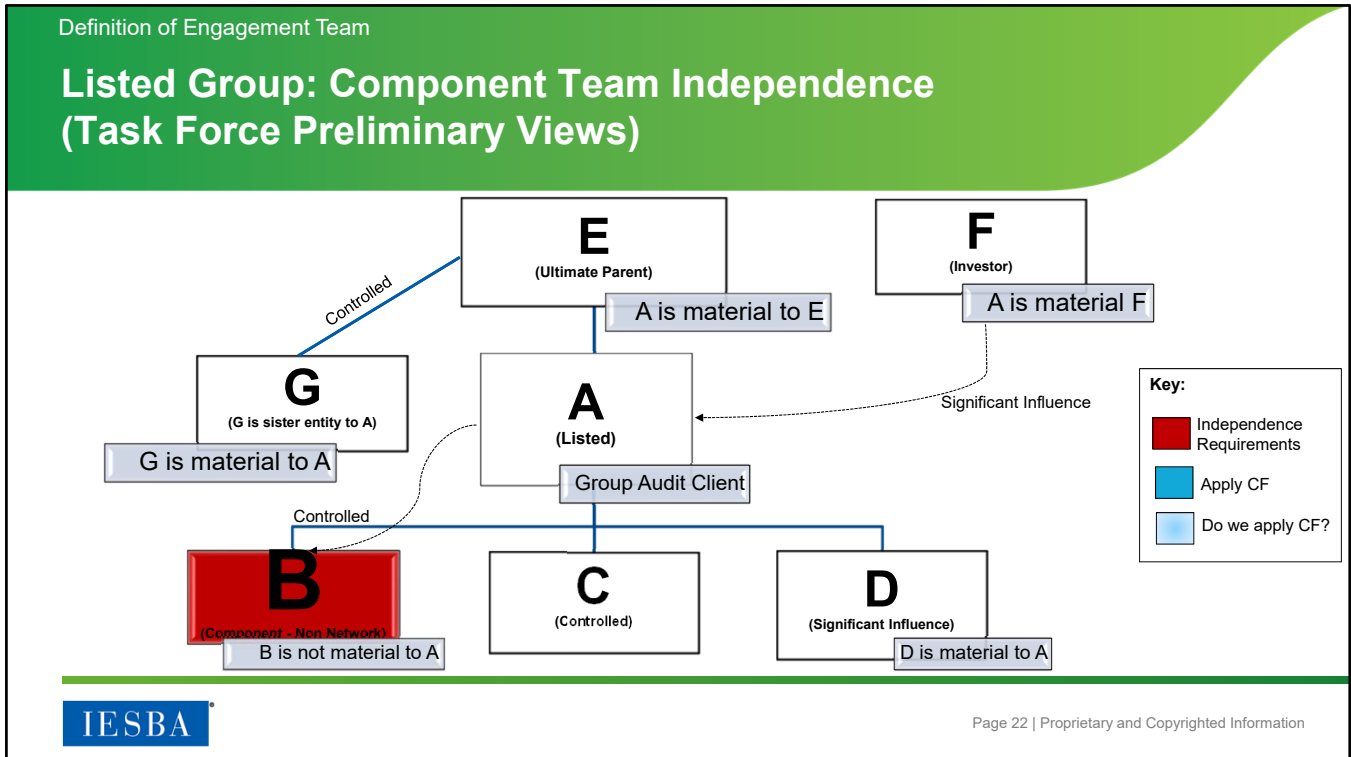


B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is MATERIAL to A, the Group Audit Client (Listed)
- B is audited by component auditor outside the network

Proposal:

- As it is a material entity (to A, the Group Audit Client (Non-Listed)) audited by component auditor outside of the network, should the CF apply to the individuals auditing the related entities upstream (A and E)?



B is the entity in focus:

- so the independence requirements applies to individuals auditing B
- B is IMMATERIAL to A, the Group Audit Client (Listed)
- B is audited by component auditor outside the network
- B is immaterial to A and audited by component auditor outside of the network so no other provisions apply

Matters for IESBA Consideration: Key Principles: Independence for Component ET

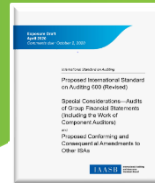


Views on, or reactions to, the Task Force's preliminary thinking



Whether members has any other comments

ISA 600 (Revised) Group Audit and Component Auditor



Definition of CA

An auditor who, at the request of the group engagement team, performs audit procedures related to a component for purposes of the group audit. A component auditor is a part of the engagement team. (Ref: Para. A13–A14)

A13. References in this ISA to the **engagement team** include members of the **group engagement team** and **component auditors**. The engagement team includes individuals from the group engagement team's firm and may include individuals from a network firm, a firm that is not a network firm, or an external service provider.

A14. In some circumstances, the group engagement team may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group engagement team is not considered a component auditor for purposes of this ISA.

A4. ...For this purpose, the group engagement team uses professional judgment in determining the components for which audit procedures will be performed (by the group engagement team or component auditors on its behalf). The manner in which components are viewed for purposes of planning and performing a group audit may be influenced by the group structure, but may or may not be aligned with the way in which the group is organized, which could be, for example, by legal entities, geographic locations, or lines of business.

A5. For example, for a group comprised of 15 legal entities that are required to be consolidated under the provisions of the applicable financial reporting framework (i.e., group financial statements), the auditor may plan and perform the group audit by combining these 15 entities into three components based on the commonality of information systems and systems of internal control.

Due to the proposed revisions in ISA 600 ED (and expanded definition of ET as per ISA 220 (Revised)), how a group engagement team is structured have changed:

- The ET in ISA 600 now comprises the Group ET AND Component Auditors, which includes individuals from the network and non-network and service providers.
- CAs may or may not be structured/organized via the legal form, rather based on facts and circumstances that Group Auditor deem appropriate for the purposes of Group FS.

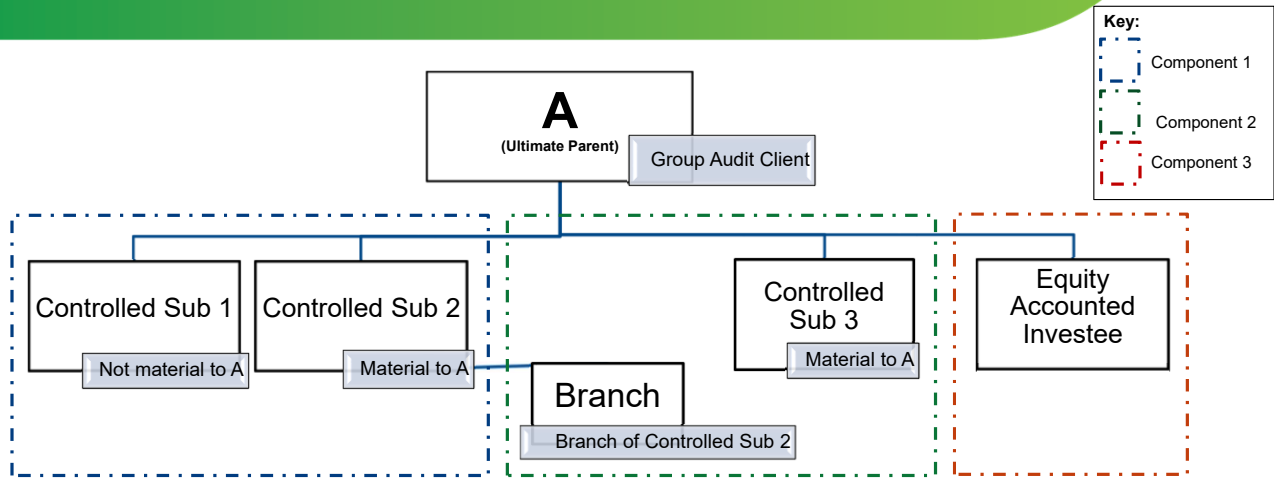
Non-Network Component Auditor – Group Audit

What are the RER including the independence requirements mean for the non network component auditor in a Group audit?

- 1 Establish the linkage between Related Entity and component
- 2 Minimum independence requirement in all situations?
- 3 Application of the Code where the Group is PIE and component is non-PIE?

Independence for component auditors in the context of Group Audit

1: Establish the linkage between Related Entity and component



Entities below the parent company may not be organized based on its legal structure for the purposes of the Group Audit

ISA 600 (Revised) Application Material:

A4. ...For this purpose, the group engagement team uses professional judgment in determining the components for which audit procedures will be performed (by the group engagement team or component auditors on its behalf). The manner in which components are viewed for purposes of planning and performing a group audit may be influenced by the group structure, but may or may not be aligned with the way in which the group is organized, which could be, for example, by legal entities, geographic locations, or lines of business.

A5. For example, for a group comprised of 15 legal entities that are required to be consolidated under the provisions of the applicable financial reporting framework (i.e., group financial statements), the auditor may plan and perform the group audit by combining these 15 entities into three components based on the commonality of information systems and systems of internal control.

2: Minimum independence requirement in all situations

Task Force Preliminary Views

Must be independent of the component and the entities downstream
 - Task Force deliberating: upstream entities (e.g. controlled, materiality, significant influence)?

Independence requirements applicable to non-network ET also applies to the component firm and its network firms

Individuals in part (b) definition of audit team for the Group audit do not include individuals from component audit firm

Definition of audit team:

- (a) All members of the engagement team for the audit engagement;
- (b) All others within a firm who can directly influence the outcome of the audit engagement, including:
 - (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement, including those at all successively senior levels above the 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 engagement; and
 - (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement;

and

- (c) All those within a network firm who can directly influence the outcome of the audit engagement.

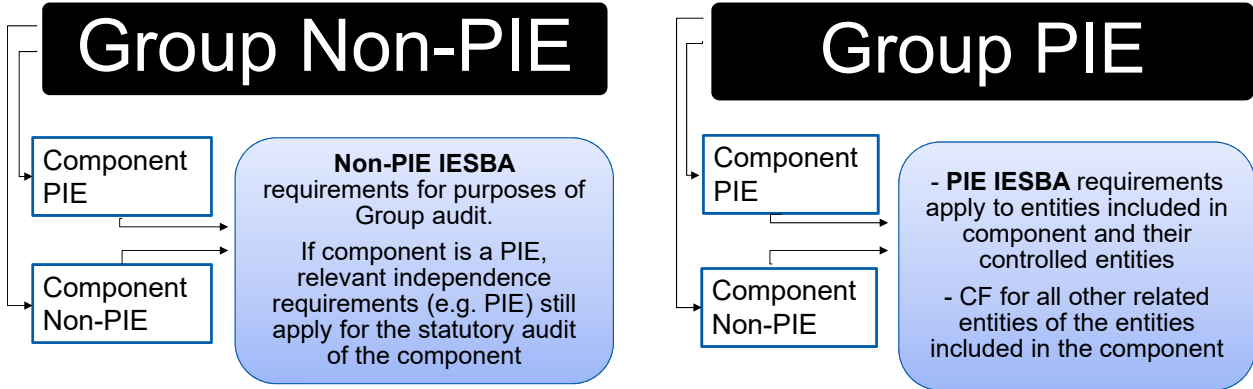
Independence for component auditors in the context of Group Audit

3: Application of the Code where the Group is PIE and component is non-PIE

PIE/Non-PIE

- The Group entity is a public interest entity (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
- When there is a breach of independence at a component auditor and how it was remediated if the group auditor still intends to rely on the component auditor's work

3: Task Force Preliminary Views



**Matters for IESBA Consideration:
Key Principles: Non-Network Component Auditor – Group
Audit**



Views on, or reactions to, the matters presented



Whether members has any other comments

Further matters to be addressed

- Breaches
 - Review breaches provisions when there is a breach of independence at a non-network component auditor (ET or firm/network firm)
- Provisions in Part 4B
 - Conforming amendments as a result of amendments to defined terms
 - Confirmation if there are circumstances which impact assurance engagements

Matters for IESBA Consideration: Further matters to be addressed



Views on, or reactions to, the matters presented



Whether members has any other comments

Task Force Next Steps

Q3 and Q4 Activities

- Continue developing the key principles identified during this presentation
- Continuing coordination with ISA 220 and ISA 600 Task Forces
- Seek engagement with various stakeholders:
 - ✓ Regulators and audit oversight bodies (e.g. IFIAR)
 - ✓ IESBA CAG (September 2020)
 - ✓ National Standard Setters
 - ✓ Forum of Firms
 - ✓ Small and Medium Practices (July 2020)
 - ✓ Professional Accounting Organizations in major jurisdictions

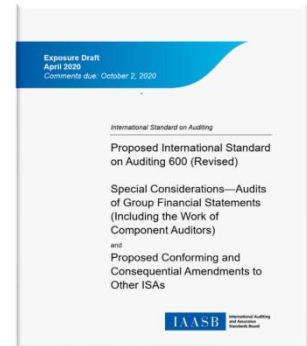


IAASB WEBINAR ON THE PROPOSED ISA 600 ED

- Webinar covering the recently released ED of Proposed ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.
- The webinar is scheduled for **Thursday, June 11, 2020 from 8:00 am EDT.**
- Len Jui, IAASB Member and Chair of the ISA 600 Task Force, will explain the background of the project and the key proposed revisions to ISA 600 (Revised).
- A follow-up webinar will be held in August 2020.
- This webinar will be recorded and placed on the IAASB Website at a later date.

Register here:

https://zoom.us/webinar/register/WN_eOqCWTCoSfeydDHIkTCWjQ





The Ethics Board

www.ethicsboard.org
