Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits

Dear Sirs:

Assirevi is the association of the Italian audit firms. Its member firms represent the vast majority of the audit firms licensed to audit companies listed on the Italian stock exchange and other public interest entities in Italy, under the supervision of CONSOB (Commissione Nazionale per le Società e la Borsa).

Assirevi promotes technical research in the field of auditing and accounting and publishes technical guidelines for the benefit of its members. It collaborates with CONSOB, the Italian accounting profession and other bodies in developing auditing and accounting standards.

Assirevi is pleased to submit its comments on the Exposure Draft “Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits” issued by IESBA in February 2022, as detailed in the enclosed document.

Should you have any queries, please do not hesitate to contact us.

Yours faithfully,

Gianmario Crescentino
Chairman

(Enclosure)
COMMENTS ON THE IESBA EXPOSURE DRAFT

Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits
(February 2022)

Assirevi is grateful for the opportunity to provide its comments on this Exposure Draft. Our Association fully agrees on the aim of strengthening the independence rules applicable to a group audit, with particular reference to the ethical and independence requirements applicable to component auditors. The Code in force does not fully address the requests of ISA 600 (Revised) and auditors need more detailed guidelines. However, we wish to bring beforehand to the IESBA’s attention a specific issue arising from the Exposure Draft. In fact, the inclusion of component auditors in the definition of Engagement Team (hereinafter “ET”) and the application to component auditors outside a group auditor firm’s network of the same independence requirements which apply to the group auditor could result in a completely unbalanced trade-off for the component audit firms. This would be true both with respect to the nature of the activities required to them and in relation to the economics of the audit activity on the financial statements of the component. Accordingly, it is highly probable that, due to the new independence requirements proposed in Section 405, audit firms outside the group auditor firm’s network may prefer not to pursue and/or accept a component audit engagement rather than bearing the cost to implement complex procedures aimed at monitoring the expanded independence requirements envisaged in the Exposure Draft. This does not appear to be in line with the overall aim – currently pursued in the EU and other jurisdictions - to discourage market concentration, as the revised framework would facilitate the choice of a sole group auditor. Therefore, Assirevi would respectfully suggest that the IESBA should consider more balanced requirements, as further detailed in the following comments.

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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)?

With regard to the new definitions used in Section 405 in relation to group audits, Assirevi has no particular comments since they are almost completely aligned to the provisions of ISA 600 (Revised). However, it is worth focusing on the definition of “audit team for the group audit”. This definition includes under lett. (d): “Any individual within a component auditor firm outside the group auditor firm’s network who can directly influence the outcome of the group audit”. As clarified in the explanatory memorandum (see page 14): “it would be rare in practice for such individuals to be able to directly influence the outcome of the group audit if they are not otherwise performing audit work at a component”. 

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The situation described under lett. (d) would be rare and difficult to be ascertained. Furthermore, in Assirevi’s view, the qualification of “a component auditor firm outside the group auditor firm’s network who can directly influence the outcome of the group audit” is not fully consistent with the rule under ISA 600 (Revised), para. 16(b), which clearly states that the outcome of the group audit is all up to the group auditor engagement partner. In effect, “the group engagement partner shall [...] be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement”. Therefore, Assirevi suggests excluding lett. (d) from the definition.

The definition of “key audit partner” according to the revised version does deserve another comment: “other audit partners” might include, for example, engagement partners for certain components in a group audit such as significant subsidiaries or divisions. This definition is supplemented by the new paragraph 405.11 A1: “The group engagement partner might determine that an engagement partner who performs audit work related to a component for purposes of the group audit is a key audit partner for the group audit because that individual makes key decisions or judgments on significant matters with respect to the audit of the group financial statements on which the group auditor firm expresses an opinion”.

Assirevi believes that the wording of the guideline could be improved by explicitly specifying the steps to be followed by the group engagement partner. The guideline could clarify that the group engagement partner is required to (i) firstly, assess whether there are any component engagement partners who can make key decisions and, should this be the case, (ii) qualify them as key engagement partners and give them proper notice in this respect. Once they have been made aware of such circumstance, they will be subject to the provisions applicable to a key audit partner. The use of the expression “might determine” proposed in the guideline does not make it clear what the obligations of the group engagement partner are.

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?

Section 405 (chapter 1) extends the independence requirements applicable to the GA to the CA firms within and outside the GA firm’s network. The proposal will inevitably enlarge the perimeter of the affected entities not only to the controlled or controlling entities with respect to the audited entity, but also to all the related entities within the audited group. Therefore, the new requirements extend the IESBA independence requirements to audit firms that are not part of the GA firm’s network also where the same CA carries out only limited audit procedures or audit procedures on a limited or not material part of the audited group. In Assirevi’s view, the IESBA’s proposal
extending the independence requirements outside the GA firm’s network does not appear to be advisable, in particular where the CA engagement partner of the CA firm outside the GA firm’s network is not identified as a key audit partner by the GA.

In practical terms the proposed Section 405 will force the CA firm outside the GA firm’s network to further expand independence verification procedures to a much broader perimeter, including entities (i.e. all the related entities) where any threats to the auditors’ independence can be reasonably excluded upfront. An inevitable side effect of such new independence provisions for CA outside the GA firm’s network will be to discourage audit firms to enter in the audit of a large PIE group when they are not GA. Assirevi suggests therefore that the scope of the independence rules required by the IESBA Code for CA firm outside the GA firm’s network and for the individuals of that CA firm should be reviewed and restricted only to the controlled entities of the company audited by the CA firm outside the GA firm’s network.

In our view, it is appropriate for independence rules to cover the PIE parent company and its related entities. However, our concern is referred to the applicability to the component’s related entities. In particular, we believe that, at the component level, a balanced solution could be achieved by restricting the relevant perimeter to the component’s controlled entities, while excluding other related entities, such as controlling entities and sister companies. On the subject of financial interest and financial relationships, we refer to our response under no. 5 below.

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 partially agree with the requirements in Section 405 concerning non-network CA firms. In particular:
   (i) We agree with the provisions of R405.6 (a).
   (ii) We agree with the requirements in R405.6 (b) to the extent that the Code clearly identify the “entity on whose group financial statements the group auditor firm expresses an opinion” as the entity itself, without including any related entity. Extending the perimeter to related entities would result in additional complexities and restrictions. The unintended consequences may lead to creating excessive and onerous obligations for the CA, with the potential to reduce the number of available auditors and increase costs for the companies. While the explanatory memorandum does include an explanation and a graphical example that seems to exclude the related entities from the requirements set forth in R405.6 (b), we believe that the public interest should be better served by making this clearer and including it into the definitions.
   (iii) R405.6 (c): In this respect, we urge the IESBA to clearly define the term “entity on whose group financial statements the group auditor firm expresses an opinion” by stating that it does not include the related entities and only refer to such entity.
(iv) We believe that the requirements in **R405.7 and R405.8** should be clarified in order to explain what the expression “knows, or has reason to believe” means in terms of monitoring processes and, in general, internal systems of quality control. In our view, the implementation of specific processes to proactively identify and monitor the relevant relationships or circumstances involving the group audit client at the level of the component auditor firm outside the group auditor firm’s network may cause the issues and unintended consequences explained above, with all the potential negative impacts described in the explanatory memorandum.

(v) We believe that the provisions in **R405.10** should be clarified, stating that the requirements do not imply that, if the group audit client is a listed entity, the component auditor firm outside the group auditor firm’s network should be independent from the related entities of the group audit client or of the component audit client. As outlined in the explanatory memorandum (see pag. 18), we believe that requiring the component auditor firm outside the group auditor firm’s network to be independent also of the related entities would result in “unintended consequences in going down a prescriptive path of prohibitions” that may potentially restrict “the pool of non-network firms that could act as CA firms, leading to increased audit market concentration” (see previous paragraphs). In this respect, we urge the IESBA to clearly define the term “entity on whose group financial statements the group auditor firm expresses an opinion” by stating that it does not include the related entities and only refer to such entity.

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?

Section 600 requires a firm to evaluate whether non-assurance services provided to an audit client create threats to independence. The application of paragraph R405.10 requires a component auditor firm to apply the independence requirements for non-assurance services for public interest entities to the component audit client where the group audit client is a public interest entity. We believe that application of paragraph R405.10 should clarify if the requirement for a component auditor firm to apply the independence requirements for non-assurance services for public interest entities to the component audit client extends also to the related entities of the component audit client. We believe that, consistent with paragraph R600.10 of the Code in force and the examples reported in paragraph 405.12 A1, 405.12 A2, this clarification should state that the new requirements do not imply that the component auditor firm outside the group auditor firm’s network should be independent from the related entities of the group audit client or of the component audit client.
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?

We believe the introduction of paragraphs 405.13 A1 - 405.13 A2 is helpful in providing guidelines that can be applied by CA firms in case of requests for audit work by the GA firm during or after the period covered by the group financial statements.

We observe that par. 405.13 A1 is similar to the requirement already contained in the extant par. R400.31 of the Code, while par. 405.13 A2 refers to the application material in the version updated as a result of the non-assurance services project.

We suggest to take into account the following elements:

1. par. 405.13 A2 does not consider the application material set out in par. 400.31 A4. In our opinion this paragraph could be applicable in case of services provided in previous years to the CA client, so we suggest to include it as a reference in par. 405.13 A2;

2. par. 405.13 A2 does not address the situation of previous services provided by a CA firm to a CA client belonging to a PIE group client. Given the more restrictive rules concerning PIE group clients (as stated in R405.10), including a reference to paragraphs R400.32 and 400.32 A1 could help the clarity of provisions applicable in these cases.

In the analysis of the new paragraphs proposed and the paragraphs referred to above, we observed that the situation described in par. 400.31 A2 (“A factor to be considered in such circumstances is whether the results of the service provided might form part of or affect the accounting records, the internal controls over financial reporting, or the financial statements on which the firm will express an opinion”) appears to be too generically described. We believe that there is a real risk that many of the services provided by the auditor may ultimately turn out to be considered as included in the above definition. We suggest a clarification to the application of such provision.

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

Section 405 provides a detailed requirements and guidance to deal with circumstances where a breach of the independence requirements is identified by a CA outside the GA firm’s network.

Assirevi believes that the process itself, as outlined in section 405, is reasonable. We also agree that the evaluation to be performed by the GA should be focused on the impact of the breach upon the objectivity of the CA and thus on the ability of the GA to use the CA’s work for purposes of the group audit.

However, the proposal to apply the same independence provisions to individuals from both the GA firm and non-network CA firms would make it complex to differentiate the evaluation to be performed by the GA when the same breach has occurred within the GA network or at a non-network CA firm.
Assirevi believes that more guidance is required to support the GA in exercising its professional judgment and, in general, adequately documenting and evaluating the independence of the non-network CA firm. This is particularly important as the GA has no knowledge of – or control over – the processes in place to prevent and detect breaches to independence provision at the non-network CA. While, as requested by ISA 600 (Revised), the GA is able to be involved in the CA firm’s audit work and to review the related working paper, when it relates to compliance with independence requirements the GA could only obtain a confirmation from the CA on its commitment and ability to comply. The processes used by an audit firm to manage and monitor compliance with the independence requirements are firm-specific and cannot be disclosed to another audit firm. Once again, the unintended outcome could be a reduced possibility to use non-network CA firms, as in this case the GA will be exposed to the consequences of a potential breach incurred by a non-network CA firm over which it has no control.

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?

Assirevi agrees with the IESBA’s proposal regarding the alignment of the effective date of the “Engagement Team - Group Audits” provisions to the effective date of ISA 600 (Revised) – i.e., for audits of financial statements beginning on or after December 15, 2023. This coordination would allow the application of Independence Standards in the context of the group audit resulting from this project and would contribute to maintaining and strengthening public trust and confidence in group audits.

Assirevi’s main concerns, however, pertain to the practical implications of the need to ensure this coordination for firms and individuals involved in an engagement to perform an audit of group financial statements. Specifically, as already mentioned in our comments to questions n. 4 and n. 5, the potential impact of the required changes to audit firms’ systems of quality management will require audit firms (not limited to those which identify themselves as component auditors) to appropriately implement new independence policies and procedures. This would certainly imply a material effort and significant costs (e.g.: as firms adjust their independence processes and systems, they will also need to adjust their training and support operations): in this respect, the December 15, 2023 deadline certainly seems extremely tight to allow audit firms to effectively and efficiently comply with the new GA independence requirements.