Ken Siong
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Dear Ken,

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

The Financial Reporting Council (FRC) welcomes the opportunity to comment upon the Exposure Draft Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits. The FRC has a strong interest in ensuring that the IESBA Code supports the global integrity of the accountancy and audit professions. The FRC does not mandate the International Independence Standards (IIS) for UK audit and assurance providers, and instead issues its own Ethical Standard. However, this is intended to be as least as stringent as the requirements included within the IESBA Code with respect to auditor independence. Additionally, professional accounting bodies in the UK adopt the Code as the basis of their codes of professional ethics. In consequence, the FRC strongly supports the IESBA’s endeavours to enhance the quality, clarity, and enforceability of the Code.

The FRC supports the IESBA’s aim of ensuring more robust requirements in the Code to protect the auditor from threats to independence arising within the context of group audits. We generally support several specific measures included in the Exposure Draft, but we do have concerns on some of the specific proposals.

We especially welcome the co-ordination between the IESBA and the IAASB on the use of common definitions based on ISA 220 (Revised) and ISA 600 (Revised). We also support the alignment of the Code’s definition of Engagement Team with that set out in ISA 220 (Revised). Additionally, the close interaction between the proposed revisions and relevant ethical requirements set out in ISA 600 (Revised) is welcome, including the requirements for the Group Engagement Partner to take responsibility for understanding and complying with relevant ethical requirements. In our view, the proposed independence requirements for group audits also help clarify and strengthen the Code. The procedures for communicating a breach of independence requirements for component auditors will also form an important addition to the Code.
Our principal concerns relate to the proposed treatment of Component Auditors. As set out in our response to Question 5, we do not consider it appropriate for the Component Auditor to possess any financial interest in any part of the group entity to which the component belongs. We also have concerns around alternating between specific requirements and the conceptual framework for considering similar independence risks, for example as set out in paragraphs 50 and 59 of the Explanatory Memorandum. This approach could result in different responses to the same threat driven by whether the Component Auditor is a member of the same network as the Group Auditor or not. We do not believe that outcomes for Component Auditors should differ simply based on whether they are or are not included within the Group Auditor’s network.

Our detailed responses to the consultation can be found in the annex to this letter. If you have any questions relating to this response, please contact myself or Peter Kitson (p.kitson@frc.org.uk).

Yours sincerely,

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Annex: Responses to the questions set out in the Explanatory Memorandum

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 “assurance team;” and
   (b) The explanatory guidance in paragraphs 400.A – 400.D?

The FRC agrees with the proposed changes to definitions in the Code relating to the Engagement Team, ensuring alignment with the terminology used in ISQM 1. The explicit definition of who is a member of the Engagement Team to include individuals from component auditor firms as well as other service providers is a welcome change which supports the overall clarity of the Code. We also support the direction of travel with respect to the explanatory guidance included in paragraphs 400.A through to 400.D. We welcome the alignment between paragraph 400.D and ISQM 2 paragraph 9, confirming that an Engagement Quality Reviewer is part of the Audit Team, but not the Engagement Team.

In paragraph 400.B we believe the drafting would be improved by stating the definition of a service provider and then confirming that this definition is aligned with ISQM 1. We also consider that the definition of external expert provided in the final bullet point of paragraph 400C would benefit from closer alignment with that set out in ISA 620, paragraph A12.

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)?

We agree with this proposed change, and welcome explicit provision for the sourcing of Engagement Quality Reviewers from outside a firm and its network within the Code. By way of comparison, the FRC's Ethical Standard requires external engagement quality reviews in several circumstances. These include instances include where the total fees for services rendered to an audited entity which is not a public interest entity is between 10% and 15% of the firm's total fee income (paragraph 4.31), and the provision external quality reviews for new firms (paragraph 4.32).

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)?

The FRC generally agrees with the proposed new defined terms used in Section 405. We consider the cross-referencing between the IESBA Code and the relevant auditing standards to be appropriate. We do however note our discomfort with the use of the word “client” with respect to certain of the definitions, since ultimately the audit is performed on behalf of the shareholders or owner of the entity, rather than the entity itself.

We welcome the attempt to align the definition of Component Audit client in the Code with that provided by ISA 600 (Revised). However, the absence of application guidance here may make it harder for practitioners to navigate the practical implementation of the Code. While the
definition is aligned with that provided by ISA 600 (revised), the proposed drafting could be improved by reference to specific examples, such as that provided for independence considerations around inventory testing provided in paragraph 405.12 A2 in the proposed revisions.

The FRC also believes that the proposed amendments to the Code could be improved with the provision of application guidance to consider cases where either the Group Auditor or Component Auditor is required to follow ethical standards other than the Code due to laws and regulations. It would be helpful to set out practical considerations for where the relevant ethical requirements set by the Group Auditor are different from those set out by the Code. This could cross-reference paragraphs 25(b), 27, 45(c) and related application material included within ISA 600 (Revised). This guidance could also refer to the practical suggestions included within paragraph A40 of ISA 220 (Revised).

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?

The FRC agrees with the principles set out for individuals in relation to group audit, namely that the same independence provisions that apply to those individuals used by the Group Auditor firm and the Component Auditor firms within the network should also apply to individuals carrying out audit work at the component level from non-network firms. This aligns with the definition of the Engagement Team set out in ISA 220 (Revised).

With respect to the principles set out in relation to independence for firms engaged in a group audit (Question 4b), including Component Auditor firms both within and without the Group Auditor firm’s network, the FRC supports the proposal to explicitly require that the Group Auditor firm’s network ensures that both the group and component audit teams be independent as set out in paragraphs R405.4 and R405.5.

We do however have reservations around reverting to the conceptual framework set out in the Code for evaluating threats for cases where the Component Auditor is auditing a PIE component within a non-PIE group. There is a risk of increased complexity for regulatory and oversight processes if one set of independence requirements are required for group purposes, and another for the audit of the component financial statements. This complexity may both create ambiguity for stakeholders, and application difficulties for component auditors. In practice, the Component Auditor may well adopt the more stringent independence requirement for the audit of the PIE component for the purposes of performing group procedures, as this is likely to be simpler in practice compared to addressing the complexities arising from this arrangement. We therefore suggest that the Code requires that group audit procedures for PIE components within non-PIE groups are required to adhere to those ethical requirements which are most stringent for both the audit engagement and the performance of group audit procedures to prevent such complexities from arising.
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?

The FRC supports the inclusion of explicit prohibitions on audit firms holding financial interests or issuing loans and guarantees, but we do not believe that the specific proposals go far enough. Component Auditor firms should not have financial interests with any entities within the group in which the component sits. The component auditor should be independent of the group audit client, regardless of whether they are part of the group audit firm’s network or not. Failing to do so creates risks over public perceptions of the Component Auditor’s independence and may therefore have negative consequences for overall confidence in the financial audit process.

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?

The FRC considers the proposed application material to be reasonable and supports the clarification around the provision of non-audit services (NAS) and independence considerations from a group audit perspective. We welcome the inclusion of guidance and consider it appropriate that requirements around independence for the Component Auditor are linked to whether the group entity is a PIE or not.

In particular, we support the guidance on avoidance of the self-review threat after the provision of NAS to the component. The application guidance could be further clarified by inviting the Component Auditor to consider the importance at the overall group level of the specific financial statement line item on which they have been invited to perform group procedures. It may be that the self-review risk could be seen differently when viewed from the perspective of the overall group rather than from the perspective of the client. The guidance could also be strengthened by encouraging the Component Auditor to consult with the Group Engagement Partner on these matters.

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?

The FRC is broadly supportive of the proposed guidance, and also considers the use of extant guidance within the Code is appropriate. However, we believe that the guidance could be improved by noting that it may be appropriate to communicate and consult with the Group Auditor on these specific matters. The FRC also considers that the guidance could be enhanced to consider specific circumstances when an entity is acquired by the group. For example, scenarios where the firm acting as the auditor of a component has been providing non-audit services to the group prior to the acquisition of the component may create issues which could be construed as impinging upon auditor independence. Further application guidance on this matter would improve the overall clarity and force of the Code.
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?

The procedures to address a breach of independence within the Group Auditor’s network are a logical extension of circumstances where a breach has taken place within the Group Auditor firm itself. For situations where the Component Auditor is outside the Group Auditor network, as the guidance notes, the Group Auditor firm cannot monitor or implement procedures to ensure compliance. The proposed revisions to the Code would be improved if clarity was provided on who within the Component Auditor firm is responsible for the performance of the specific procedures set out in paragraphs R405.7, R405.8 and R405.15.

We note that requirements set out in R405.14 for Component Auditor firms inside the Group Auditor’s network is less restrictive for instances of breaches than in R405.15 for Component Auditor firms outside of that network. In the former, the Group Engagement Partner is allowed discretion to conclude whether the breach of independence requirements has been mitigated appropriately, whereas in the latter the relationship causing the breach must be removed. We do not believe this differentiation is appropriate, and that it is contrary to ISA 600 (Revised) which does not differentiate requirements for Component Auditors on whether they are a member of the Group Auditor’s network or otherwise. The IESBA Code should set the same requirements for all Component Auditors, regardless of whether they are within the Group Auditor’s network or not.

Proposed Consequential and Conforming Amendments

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

We are generally supportive of the proposed consequential and conforming amendments as set out in Chapters 2 to 6, and we have no specific observations to make on these items.

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?

We strongly support IESBA’s proposal to align the effective date for the final provisions with the effective date for ISA 600 (Revised). We consider it highly desirable to do so, due to the linkages between the amendments to the IESBA Code and ISA 600 (Revised).