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Program and Senior Director
International Ethics Standards Board for Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017
The United States of America

Dear Sir,

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

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorized by law to set and promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Exposure Draft (ED).

The HKICPA appreciates the IESBA's time and effort in organizing global webinars on the ED and explaining the changes.

Overall, we support the IESBA's proposed revised definition of engagement team and other proposed new terms for purposes of specifying independence provisions for group audits. However, we have concerns on the proposed independence principles for non-network component audit (CA) firms that when the group audit client is a public interest entity (PIE), the PIE independence provisions would apply to the non-network CA firm with respect of its audit of the component even if the component audit client is not itself a PIE. The proposal would also prohibit non-network CA firms from performing non-assurance services to a component audit client (which itself is not a PIE) when the group audit client is a PIE. The consequences altogether could limit corporates' choice of auditors, intensify the concentration of audit market etc.

Accordingly, we recommend the IESBA to re-consider the applicability of PIE independence requirements to the non-network CA firm of a non-PIE entity component by applying indicative factors or providing exemption in particular circumstances, rather than adopting a one-size-fit-all criteria. Any such concessions would need to be clear to avoid misinterpretation and inconsistent application.

Our responses to the specific questions raised in the ED are set out in the Appendix for your consideration.



Hong Kong Institute of
Certified Public Accountants
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If you have any questions regarding the matters raised above, please contact Selene Ho, Deputy Director of the Standard Setting Department (selene@hkipa.org.hk).

Yours faithfully,

Jonathan Ng
Deputy Chief Executive

Question 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?

We agree with the revised definitions to the terms set out in Question 1(a). In particular, we concur with the IESBA’s approach to align the Code’s definition of “engagement team” with the definition in ISQM 1 for consistency and to avoid confusion.

We also consider the explanatory guidance in paragraphs 400.A to 400.D has appropriately assisted users to differentiate “engagement team” and “audit team”.

Question 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 do not have any comments to this question.

Question 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)?

We generally agree with the proposed new defined terms which align with the existing defined terms in the Code and those in ISA 600 (Revised) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*.

We note that the proposed definition of “Audit team for the group audit” includes, among others,

- (c) all those within a network firm of the group auditor (GA) firm’s network who can directly influence the outcome of the group audit; and
- (d) any individual within a component auditor (CA) firm outside the GA firm’s network who can directly influence the outcome of the group audit.

It could be helpful if the IESBA could clarify the personnel “who can directly influence the outcome of the group audit” in the context of (c) and (d), for example, whether the personnel set out in (b)(i) within or engaged by the GA firm who can directly influence the outcome of the group audit applies to (c) and (d).



Question 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?

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

As proposed in paragraph R405.10, when the group audit client is a public interest entity (PIE), the independence provisions applicable to a CA firm which is outside the GA firm's network in relation to the component audit client are the PIE provisions, even if the component audit client is not itself a PIE. Consequently, as explained in paragraph 405.12 A1, the non-network CA firm should apply the PIE independence requirements on the provision of non-assurance services to a component audit client as the group audit client is a PIE. As a result, the non-network CA firm is prohibited from providing various non-assurance services to the non-PIE entity component since it belongs to a PIE group.

We consider the proposal might result in unintended consequences, for example, the non-network firm might turn down the appointment to act as the CA firm of a PIE group so as to continue the provision of non-assurance services to the component audit client. Eventually, the proposed revisions would limit corporates' choice of auditors and assurance services providers, potentially increasing the costs for the non-PIE entities due to having to engage different firms for audit and non-assurance services. It may intensify the concentration of audit market, which could have a negative impact to the audit quality in general.

In this connection, we recommend the IESBA to re-consider the applicability of PIE independence requirements to the non-network CA firm of a non-PIE entity component by providing exemption in particular circumstances, rather than adopting a one-size-fit-all criteria. For example, allowing components that are (i) not material in monetary terms and (ii) do not impose any significant risks to the group audit and (iii) obtained consent from the group engagement partner to apply non-PIE independence requirements. Requiring the PIE independence provisions to apply to the non-network CA firm with respect of its audit of the component as such, even if the component audit client is not itself a PIE, seems to be unduly burdensome.

To enhance clarity and align with the requirements of ISA 600 (Revised)¹, we also suggest the Code to require the group engagement partner to take responsibility to confirm whether the CA (including non-network CA) understands and would comply with the relevant ethical requirements, including those related to independence according to the Code's provision.

Likewise, we also suggest the IESBA to re-assess the application of PIE independence requirements to the provision of non-assurance services to a non-PIE entity component audit client of a PIE group.

We recognize that any exemptions granted may contradict paragraph 25(b) of ISA 600 (Revised) which requires the CA to apply independence requirements that apply to the group audit engagement. Accordingly, any such concessions would need to be clear to avoid misinterpretation and inconsistent application.

¹ Paragraph 25(b), ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*



It would also be helpful if the IESBA could clarify, for a non-PIE component entity that belongs to a PIE group, whether the PIE independence requirements would apply to its non-network firm auditor who is not engaged to perform any procedures for the purposes of the PIE group audit.

Fees

We urge the IESBA to clarify whether the fee dependency provisions applicable to a PIE (paragraph R410.28) and the requirement for a firm to disclose fee-related information of a PIE client unless otherwise specified (paragraph R410.31) would, as a result of the ED, apply to a non-network CA firm of a component audit client which itself is not a PIE, but the group audit client is a PIE.

We are of the view that making public disclosure of the fee-related information of non-PIE entities would not necessarily provide any benefit on the visibility about the professional relationships between the firm and the audit client if the relevant audited financial statements are not publicly available, which is generally the case of non-PIE entities. Thus, we recommend the IESBA to re-assess their application in the context of a non-network CA firm and include explicitly in R410.31 as an exception.

Question 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?

Proposed paragraph R405.6(b) states that a CA firm outside the GA firm's network shall not hold a direct or material indirect financial interest in the entity on whose group financial statements the GA firm expresses an opinion.

While the proposed paragraph R405.6 is similar to the Code's extant paragraph R510.6 (except that the materiality of the component audit client to the group audit client is not considered), it is unclear whether relevant requirements and application material with respect to financial interest in section 510 applies to the context of the proposed paragraph, for example,

- Whether the assessment of "materiality" referred to in the proposed paragraph R405.6 should follow the relevant provisions in section 510;
- Whether paragraphs R510.4 to R510.9 apply to the context of the proposed paragraph R405.6 as to the capacity that the financial interest is held; and
- Whether the application materials from paragraphs 510.10 A1 to 510.10 A13 "Financial Interests – Other Circumstances" apply to the context of the proposed paragraph R405.6.

It is also not clear whether a non-network CA firm should also not hold a direct or material indirect financial interest in other components of the group, such as the subsidiary, associate or joint venture companies of the parent entity.

We recommend the IESBA to provide clarification on the applicability of section 510 to the proposed paragraph R405.6 and with respect to the above.



Question 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?

As set out in our responses to Question 4, we have concerns on the proposed independence principles for non-network CA firms when the group audit client is a PIE while the component audit client is not itself a PIE.

We nevertheless consider proposed paragraphs 405.12 A1 and A2 are clear and appropriate for their intended purposes.

Question 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 do not have any comments to this question.

Question 8

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

R405.7 and R405.8 specify that if the CA firm becomes aware of a specified relationship or circumstance indicating a potential threat to its independence, it should evaluate its independence against the situation identified and address those threats, if appropriate.

While the CA firm may address such situations appropriately without breaching the independence requirements, we suggest the Code to require the CA firm to inform the GA firm of such circumstances, including the CA firm's assessment and actions taken, for the GA firm to evaluate whether there are other aspects relating to the circumstances that could trigger independence concerns at the group level or among other CA firms.

Question 9

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

We do not have any comments to this question.

Question 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 do not have any comments to this question.