

**The Japanese Institute of
Certified Public Accountants**

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Mr. Ken Siong
IESBA Program and Senior Director
International Ethics Standards Board for Accountants
International Federation of Accountants
529 Fifth Avenue, 6th Floor,
New York, NY 10017
USA

Dear Mr. Siong:

Re: JICPA comments on the IESBA Exposure Draft, *Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits*

The Japanese Institute of Certified Public Accountants (JICPA) expresses its appreciation for the activities of the International Ethics Standards Board for Accountants (IESBA) and is grateful for the opportunity to share its comments on the IESBA Exposure Draft, *Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits*.

Our responses to the specific questions raised by the IESBA are as follows:

I. Request for Specific Comments

Proposed Revised Definition of Engagement Team

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| <p>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)</p> <p>(a) The revised definitions of the terms “engagement team,” “audit team,” “review team” and “assurance team;” and</p> <p>(b) The explanatory guidance in paragraphs 400.A – 400.D?</p> |
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(Comment)

We agree in principle with the proposed changes to the Code relating to the revised definitions of

Engagement Team. Incidentally, we have the following comments on paragraph 400.B.

The Exposure Draft provides definitions of terms, "audit team," "review team," etc., ensuring the consistency with those of ISQM1. On the other hand, the term "service provider" included in the definition of "engagement team" is a newly adopted term, and paragraph 400.B describes the term as a term used in ISQM1. However, since "service provider" references ISQM1 but it is not defined as a term specific to the IESBA Code of Ethics, it is not very clear what it means specifically or what role it is expected to have in the context of the Code. Therefore, we suggest including in an application material of Section 405 an example of a "service provider" in order to help users of the Code understand the term. Specifically, please refer to our comments on Q3.

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)?

(Comment)

We agree with the proposed changes to those definitions as it relates to the EQRs.

We also recognize that not only EQRs but also any other individuals engaged by the firm, who perform the roles described in subparagraphs (b)(i) through (iii) in the definitions of "audit team," "review team," and "assurance team" should be included in the "audit team," "review team," and "assurance team." Accordingly, we agree with the addition of the phrase, "or engaged by," in subparagraph (b) of the definitions of terms “audit team,” “review team” and “assurance team, respectively,” in the Exposure Draft.

We also note that a "service provider," as described in Q1 above, may be used in the role of "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 engagement partner" described in subparagraph (b)(i). Nevertheless, such role is considered to be a proprietary function normally equipped within a firm. Therefore, we expect that it should be clarified in the Basis for Conclusions to facilitate users of the Code to understand the situation where a firm "engages" an individual from outside the firm to play the role described in subparagraph (b)(i).

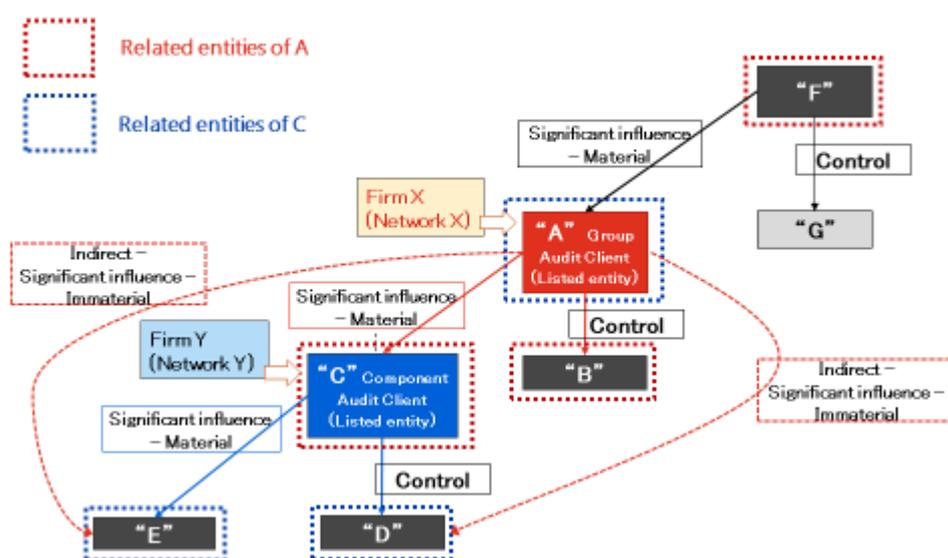
Independence in a Group Audit Context

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)?

(Comment)

We basically agree with the new defined terms related to group audits, except for the following issues.

We use the diagram set out below to illustrate the issues. Entity A is a listed group audit client and Firm X audits the entity as a group auditor firm (the financial statements is prepared in accordance with IFRS, audited in accordance with ISAs and IESBA Code of Ethics). Entity C is an affiliate of Entity A and a listed entity, and an equity method is applied to its financial information for the group reporting purpose. Firm Y audits the entity for group audit purposes as a component auditor firm outside Firm X’s network (the financial information is prepared in accordance with IFRS, audited in accordance with ISAs and IESBA Code of Ethics). Entity A has a direct financial interest in Entity C that gives it significant influence over Entity C and the interest is material. Therefore, Entity C is a related entity for the purpose of Entity A's group audit under paragraph R400.20. Entity C has a subsidiary Entity D and an affiliate Entity E. Entity C has a direct financial interest in Entity E that gives it significant influence over Entity E and the interest is material. For the purpose of Entity A's group audit, neither Entities D nor E are in the scope of the group audit, or they are not related entities under paragraph of R400.20. On the other hand, for the purpose of Entity C’s separate group audit, Entities D and E are within the scope of the group audit and are related entities under paragraph R400.20.



1. Concerns that there are differences in the scopes of independence requirements between component auditor firm and individual members of an audit team of a component auditor

firm.

The diagram above illustrates our understanding of the scope of entities of which firms shall be independent in the Exposure Draft. The proposed subparagraph R405.6 (a) requires Firm Y, the component auditor firm, to be independent of Entity C, component audit client and Entity D, an entity controlled by Entity C for the purpose of the group audit of Entity A. In addition, Firm Y is prohibited from holding a financial interest, and loans and guarantees with respect to Entity A, the group audit client, in accordance with paragraphs R405.6 (b) and (c).

On the other hand, individual members of the audit team of Firm Y, the component auditor firm that audits Entity C, as members of the audit team for group audit of Entity A, are required to be independent of Entity A, the group audit client, and its related entities in accordance with paragraph R405.3. The entities are those surrounded by red dotted lines in the diagram above.

In other words, the scope of entities of which Firm Y is required to be independent for the purpose of the group audit of Entity C is different from the scope of entities of which the members of the audit team of Firm Y, the component auditor firm that audits Component Entity, are required to be independent.

Under the extant Code of Ethics, members of the audit team of Firm Y, the component auditor firm that audits Entity C, are required to be independent of Entities A, C, D and E. However, under the Exposure Draft, the members are required to be independent of Entities B and F as well as Entity A in accordance with paragraph R405.3. Therefore, for members of the audit team of Firm Y that audits Entity C, the scope of related entities of which the members are required to be independent is broader than the requirements in the extant Code of Ethics, and the individual member's independence of the entities that they audit may not be balanced in relation to the audit of Entity C. When the members of the audit team of Firm X, the group auditor firm that audits Entity A are not required to be independent of Company G, a subsidiary of Entity F which is an upstream related entity of Entity A, it is not reasonable that the members of the audit team of Firm Y, component auditor firm that audits Entity C are required to be independent of Entity B, a subsidiary of Entity A which is an upstream related entity of Entity C.

Therefore, in order to maintain the balance, we propose that the same requirements as in paragraph R405.6, which apply to the component auditor firm, be applied to individual members of the audit team of the component auditor firm outside the group auditor firm's network. We also propose that Entity A and components within the Entity A's group be included in the scope of the "reason to believe" test as described in paragraph R405.7. We propose specifically including subsidiaries of the component audit client in the scope of the related entities of which independence is required in accordance with subparagraph R405.6 (a), and, with respect to other related entities of the component audit client, in addition to the requirements in subparagraphs R405.6 (b) and (c), we propose including the components within Entity A's group in the scope of the "reason to believe"

test described in paragraph R405.7, thereby establishing the provision that would effectively maintain independence.

The practical imperatives behind these proposals include the following.

The Exposure Draft would make it difficult for an individual member of the audit team of a component auditor firm outside the network to always be required to confirm information regarding changes (due to acquisitions, mergers, etc.) in the components of the group audit client prior to the effective date of such changes, i.e., such transactions. Individuals of component auditor firm outside of the network will not have access to the database in a timely manner which is maintained by the group auditor firm that records the related entities of the group audit client. In addition, it will be almost impossible for other professional accountants, such as those who provide consultation and those in the so-called chain of command of the component auditor firm outside the group auditor firm's network, to be independent of the group audit client and its related entities if the related entities of the group audit client are not controlled through a database recording the group audit client and its related entities. In implementing in practice the proposed provisions in the Exposure Draft, it may be physically possible to take technical measures including preparing a program to overcome these practical difficulties, but it is also necessary to address issues such as control over the information about related entities of the audit client and restrictions on the disclosure of confidential information.

The above practical difficulties may result in the group auditor firm's networks being forced to replace component auditor firms outside the network. The proposal in the Exposure Draft may disproportionately broaden the independence of only individuals of a component auditor firms outside the network.

2. Concerns that there are difference in the scope of independence for a component auditor firm within the group auditor firm's network and a component auditor firm outside the network.

We believe it should be considered whether or not a group auditor firm and its network firms shall be independent of the related entities within the scope required for a component auditor firm outside the network.

Therefore, we propose adding "reason to believe" test to paragraphs R405.4 and R405.5 in order to consider whether the members of audit team of the group auditor firm and its network firms shall be independent of Entities D and E, related entities of Entity C, which are not included in the scope of the related entities of the group audit client for the purpose of the group audit,

3. Newly introduced independence requirements applicable to service providers

With respect to service providers, we propose that we should discuss separately (a) service

providers that the group auditor firm uses (excluding a component auditor firm outside the network and service providers the component auditor firm uses), (b) a component auditor firm outside the network and (c) service providers that a component auditor firm uses. Specifically, we propose that the same independence requirements as those required for the group auditor firm in paragraphs 400.B and R405.3 be applied to service providers that the group auditor firm uses (excluding a component auditor firm outside the network and service providers the component auditor firm uses).

We also propose that the same requirements as those applies to component auditor firm outside the network be applied to a component auditor firm outside the network and service providers that a component auditor firm uses by including them in the paragraphs R405.6 and R405.7 as described in our proposal in 1 above.

Furthermore, paragraph A105 of ISQM1 states that commercial off-the-shelf IT applications used in audit engagements are an example of resources from a service provider. It should be clarified whether a vendor providing such commercial IT applications used in the audit engagement is included in "an individual or organization external to the firm that provides a resource that is used in the audit engagement" as described in paragraph 400.B of the Exposure Draft. If such a clarification is not established, the application material should clarify that a breach by a service provider (as an audit team member of the component auditor firm) that is detected during the course of a local audit will not be subject to communication with those charged with governance for the purpose of group audits.

4. Definition of Audit team for the group audit

In (a) of the definition "Audit team for the group audit," it is stated that "including individuals from component auditor firms who perform audit work related to components." On the other hand, the "engagement team" included in (a) of the definition "audit team" is defined as "all partners and staff performing the engagement, and any other individuals who perform procedures on the engagement." In Part 4A, the term "engagement teams" refers to individuals performing audit or review procedures." Though the term "audit work" is not defined, it is generally considered to encompass "audit procedures." Therefore, (a) of definition "audit team for the group audit" and the definitions "audit team" and "engagement team" seem to differ in terms of their scopes. We propose clarifying this point.

5. Ethical rules to be applied in group audits

Paragraph 405.2 A1 of the Exposure Draft states that ISA 600 requires the group engagement partner to confirm the component auditor firm's compliance with the relevant ethical requirements applicable to the group audits. However, each jurisdiction has added to its code of ethics its own requirements with regard to relevant laws and regulations. And, therefore, it will be increasingly

difficult for component auditor firms, especially those outside the network, to fully understand and apply the ethical requirements applied by the group auditor firms. In addition, it will be difficult to develop a system for the component auditor firms to comply with the specific ethical requirements of other jurisdictions. The extant IESBA Code of Ethics does not provide specific guidance in this regard. We believe that it is necessary to provide practical guidance to assist the component auditor firms in applying the requirements of ethics applied by the group auditor firms.

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?

(Comment)

We agree with the principles the IESBA is proposing for (a) and (b).

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?

(Comment)

We agree with the specific proposals in Section 405 regarding (a) and (b).

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?

(Comment)

We have no objection to the proposed application material relating to a non-network component auditor firm's provision of non-assurance service to a component audit client in proposed paragraph 405.12 A1, except for the following.

Paragraphs 405.12 A1 and A2 state that the application of paragraph R405.10 requires a component auditor firm to apply the independence requirements for non-assurance service for public interest entities to the component audit client that is not a public interest entity where the group audit client is a public interest entity when ISA 600 (Revised) is applied by the component auditor firm. In addition to that, the communication with those charged with governance regarding the provision of non-assurance services should be explicitly stated.

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?

(Comment)

We have no objection with respect to the application material relating to changes in component auditor firms.

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?

(Comment)

We agree with the proposal in Section 405 to address a breach of independence by a component auditor firm, except for the following.

The proposed paragraph R405.19 of the Exposure Draft requires that the group auditor firm to discuss with those charged with governance the significance of the breach at the component auditor firm and whether actions proposed or taken would satisfactorily address the consequence of the breach to enable the group auditor firm to use the work of the component auditor firm. However, the paragraph does not state the discussion where the group auditor may not use the work of the component auditor firm. The paragraph should be consistent with APPENDIX 2 that describes necessity of the discussion with those charged with governance in case the group auditor firm may not use the work of the component auditor firm because the breach at the component auditor firm is "very significant." Specifically, in paragraph R405.19 (a), in addition to the severity of the violation, we propose that the paragraph should state whether the group auditor firm may use the work of the component auditor firm by taking the necessary actions and, if not, what the group auditor firm should do to express its opinion.

Proposed Consequential and Conforming Amendments

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

(Comment)

We agree with the proposed consequential and conforming amendments as described in Chapters 2 to 6, except for the following

In paragraph R360.16, the clause "or a legal entity or business unit that is part of" is added after "a component." The clause "one or more components" is added in subparagraph R360.17 (a) and

the clause "one or more legal entities or business units that are part of the group and" is added in subparagraph R360.17 (b). However, these inserted clauses are not consistent with the proposed definition of component, "An entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit." Since paragraphs R360.16 and R360.17 are requirements, we suggest that the scope should be clarified.

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?

(Comment)

We agree with the proposal to align the effective date of the final provisions with the effective date of ISA600 (Revised).

II. Request for General Comments

● *Small- and Medium-Sized Entities (SMEs) and Small and Medium Practices (SMPs)* – The IESBA invites comments regarding any aspect of the proposals from SMEs and SMPs.

(Comment)

We do not have any specific comments.

● *Regulators and Audit Oversight Bodies* – The IESBA invites comments on the proposals from an enforcement perspective from members of the regulatory and audit oversight communities.

(Comment)

Not applicable.

● *Developing Nations* – Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular on any foreseeable difficulties in applying them in their environment.

(Comment)

Not applicable.

● *Translations* – Recognizing that many respondents may intend to translate the final changes for adoption in their own environments, the IESBA welcomes comment on potential

translation issues respondents may note in reviewing the proposals.

(Comment)

We do not have any specific comments on the wording used in the Exposure Draft from the perspective of translation into Japanese.

However, English is not the official language in Japan, thus, it is inevitable to translate the Code from English to Japanese in an understandable manner. For this reason, we pay close attention to the wording used in the Code in respect of whether it is translatable and comprehensible when translated. We therefore request the IESBA to avoid lengthy sentences and to use concise and easily understandable wording.

We hope the comments provided above will contribute to the robust discussions at the IESBA.

Sincerely yours,

Toshiyuki Nishida

Executive Board Member - Ethics Standards

The Japanese Institute of Certified Public Accountants