

5 October 2021

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submitted electronically through the IESBA website

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Re.: Exposure Draft: Proposed Quality Management-related Conforming Amendments to the Code

Dear Ken,

We would like to thank you for the opportunity to provide the IESBA with our comments on the “Exposure Draft: Proposed Quality Management-related Conforming Amendments to the Code”, hereinafter referred to as “the draft”.

Before addressing in the Appendix to this letter some of the individual questions posed in the draft, we provide some general observations on the draft.

At a principles-based level, we agree with IESBA seeking to align the IESBA Code with the changes to the IAASB’s quality management standards. In fact, except for the matter we address immediately below and in our response in the Appendix to this letter to Question 2 posed in the Explanatory Memorandum, we agree with the proposed conforming amendments in this draft.

As explained further in our response in the Appendix to the letter to Question 1, our greatest concern is what appears to be the lack of due diligence by the IAASB, IESBA and their stakeholders on the impact of the change in the definition of engagement team on engagements performed in accordance with ISAE 3000 (Revised) and ISAE 3410 – in particular where those engagements encompass information from supply chains outside of corporate groups. This issue is becoming crucial because of changes in national legislation in the EU and the draft EU directive on corporate social responsibility reporting. We urge IESBA to undertake a thorough investigation of this issue prior to incorporating the new definition into the IESBA Code.

GESCHÄFTSFÜHRENDE R VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Daniela Kelm, RA LL.M.;
Melanie Sack, WP StB

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We would be pleased to provide you with further information if you have any additional questions about our response, and would be pleased to be able to discuss our views with you.

Yours truly,

Melanie Sack
Executive Director

Wolfgang Böhm
Director Assurance Standards,
International Affairs

541/584

Appendix to Comment Letter:
Responses to Request for Specific Comments and
Request for General Comments

Request for Specific Comments

1. Do you agree with the proposed conforming amendments in this ED?

Except for the matters we address immediately below and in our response to Question 2 below, we agree with the proposed conforming amendments in this ED.

We are not convinced that the IAASB, IESBA or their stakeholders have undertaken adequate due diligence with respect to the impact of the change in the definition of engagement team on the work of other auditors on the application of ISAE 3000 (Revised) or ISAE 3410 and on the application of the IESBA Code. We quote from our comment letter to the IAASB dated May 26, 2021 on the IAASB exposure draft on the “Proposed Conforming Amendments to the IAASB’s Other Standards and Framework Due to the New and Revised Quality Management Standards” as follows:

“Our main issue relates to the incorporation of the new definition of engagement team from ISQM 1 into ISAE 3000 (Revised) and its impact on that standard and ISAE 3410. Both the IAASB and respondents (including us) to the Exposure Draft of ISQM 1 were far too focused upon the impact of the change in definition in engagement team in ISA 220 on group audits and other issues in relation to ISQM 1. It was far too late that we recognized the potential impact of the change in definition on certain kinds of engagements subject to ISAE 3000 (Revised). However, we did inform the member on the IAASB from Germany of this matter, who did address this issue with the Task Force and the Board prior to the issuance of ISQM 1 and did include this issue in the reasons for his abstention when voting on ISQM 1.

In considering this issue, we also considered the potential impact of the change in definition of engagement team on ISRE 2400 and 2410, ISAE 3402, ISAE 3420, ISRS 4400 and ISRS 4410. Based on our rather cursory consideration of the issue, we have come to the preliminary conclusion that the impact on ISRE 2400 and 2410, ISAE 3402, and ISAE 3420 will not be any different than the impact on ISAs 220 (which has been issued) and 600 (which is being developed on the basis of ISA 220 as issued). We therefore do not take issue with the impact on ISREs 2400 and 2410 and ISAEs 3402 and 3420. We also believe that the change in definition does not pose any difficulties for ISRS 4400, since anyone performing procedures on an engagement that revolves around performing agreed-upon procedures would have been covered under the previous definition. While ISRS 4400 [*sic – this should be 4410*] does not address the performance of procedures on a compilation engagement, since ISRS 4400 [*sic – 4410*] does not involve performing procedures to gather evidence, and compilations would only

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occur within an entity, or a group as defined by ISA 600, we believe that the impact of the change in definition would likely be less than that on ISAs 200 and 600.

However, we believe that the situation for some engagements under ISAE 3000 (Revised) and ISAE 3410 is very different. We note that the requirements in each of the ISAs 500 (on using the work of management's expert), 610 (using the work of internal audit), and 620 (using the work of an auditor's expert) were distilled into a paragraph each in ISAE 3000 (Revised). When ISAE 3000 (Revised) was written, consideration was also given to the nature and extent of requirements in ISA 600 that might be relevant to all assurance engagements covered by ISAE 3000 (Revised). In contrast to the treatment given to the requirements in ISAs 500, 610, and 620, only one sentence was included in ISAE 3000 (Revised) on using the work of another practitioner. This issue was deliberated at some length by the IAASB and was not an oversight.

The main reason for this very conservative treatment in ISAE 3000 (Revised) of using the work of other practitioners is the fact that ISA 600 is predicated on group management being in a position to control – or at least exercise significant influence on – the management of components and is therefore in a position to ensure that group management will be in position to obtain the information needed to prepare the group financial statements and to direct component management to have component auditors cooperate with the group auditor. This underlying assumption breaks down for certain kinds of integrated reports, sustainability reports, and green house gas statements (in particular, for scope 2 and some scope 3 emissions), in which the information included in the reports may be from outside the group from the upstream or downstream supply chains. The likelihood that practitioners are able to gain access to, and direct, supervise and review the work of, other practitioners outside of the boundary of the group in most cases is rather low.

We note that the requirements for corporate social responsibility reports increasingly cover at least upstream supply chains. These developments mean that increasingly such reports included information from outside the corporate group, but comfort about the veracity of that information varies depending upon a number of factors. Where individual entities have considerable market power over their suppliers, those entities may be able to force the use of a model similar to that in ISA 600. However, in many cases the suppliers may have greater market power than an individual entity. In those cases, a “one-to-many” report by the supplier like ISAE 3402 might be a better option because the supplier with greater market power is unlikely to have a practitioner assure custom-made reports for each consumer entity. Another option worth considering for these circumstances is divided responsibility. In any case, simply extending the definition of engagement team so that the practitioner is required to direct, supervise and review another practitioner's work on information included in the report of the entity in these circumstances is not a viable option.

In the short run, this issue will be substantially exacerbated by laws in the process of being developed within some EU member states that make entities over a certain size responsible for the compliance of suppliers outside of the EU with national social responsibility requirements, and by the current draft of the EU directive that will make assurance (using ISAE 3000, for example) on corporate social responsibility reports mandatory for entities over a certain size as part of the statutory financial statement audit. It is unclear to us at this stage of analysis

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what the implications are of the engagement team definition to the application of independence requirements for statutory financial statements as set forth by EU law for PIEs (including the “blacklist”) to practitioners assuring information in the upstream supply chain for the purposes of the statutory financial statement audit, but not otherwise involved in assuring information within a group. It is not unthinkable that the extension of these independence requirements to all firms in the supply chain may accelerate a movement towards audit-only (or at least, assurance-only) firms internationally, which we believe is not the intention of the change in the definition of engagement team.

Overall, based on these potential issues, we have come to the conclusion that the new definition of engagement team in ISQM 1 and its incorporation into ISAE 3000 (Revised) has not been subjected to adequate due diligence by the IAASB and its stakeholders (including ourselves). We therefore urgently request that the IAASB undertake a thorough examination of the potential issues we have raised together with IESBA before incorporating the change in the definition of engagement team into ISAE 3000 (Revised).”

We would like to point out that laws have recently been passed in Germany that require certain financial intermediaries to incorporate into their audited financial statements sustainability information from entities outside of the corporate group of the financial intermediaries when these financial intermediaries are involved in bringing securities labelled “green” of those entities to market. When this sustainability information is subject to assurance by another practitioner (as is contemplated by the legislation), this assured ESG information will be incorporated into the audited financial statements of the financial intermediary. However, the auditor of the financial statements of the financial intermediary will not be able to direct, supervise and review the work of the assurance practitioner at the entities issuing the securities (as may be required by ISQM 1 and ISA 220 through the change in definition to engagement team), since these assurance practitioners do work in relation to information from an entity outside of the corporate group. Furthermore, those assurance practitioners may not be independent of the financial intermediary – in fact it may be impossible for them to be so.

We expect similar issues to arise in other EU member states when the CSR Directive is passed in the EU. We therefore strongly urge IESBA to consider the impact of the change of definition in engagement team on independence requirements for CSR reporting situations for audits of financial statements prior to adopting the change in definition to engagement team.

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2. In addition to the proposed conforming amendments, the IESBA also considered the matter raised concerning decisions about accepting or providing services to a client in paragraph 300.7 A5. See explanation in the margin of paragraph 300.7 A5 (page 9). Do you agree with the IESBA's view on this matter? If not, please explain why.

We do not agree with IESBA's view on the matter because it is not the engagement partner that necessarily has the authority within the firm for decisions concerning compliance with the fundamental principles when making decisions about accepting or providing services to a client. Rather this is a decision by the firm. This means that those professional accountants within the firm assigned responsibility to make those decisions about accepting or providing services to a client make those decisions – not the engagement partner. We therefore suggest that the reference to “engagement partner” be replaced with “Those professional accountants within the firm having the authority”.

3. Do you agree with the proposed effective date? If not, please explain your reasoning.

We agree with the proposed effective dates, since those should be aligned with those of ISQM 1 and ISQM 2.

Request for General Comments

In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:

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.

We do not believe there are any special issues that arise with respect to SMEs or SMPs that are also not relevant to other entities or practices.

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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.

Since the IDW is neither a regulatory nor audit oversight body, we do not provide any comments from an enforcement perspective.

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.

Since the IDW is not from a developing nation, we have no comments on the proposals from this perspective.

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.

We have not identified any issues in relation to translation at the present time.