



**International Federation of Accountants**

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## Agenda Item

**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** New York

**Meeting Date:** April 2-3, 2007

### **Proposed ISA 600 (Revised and Redrafted), “Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)”**

#### **Objectives of Agenda Item**

1. To review the summary of significant comments received on ED-ISA 600 (issued March 2006) and the Task Force’s related responses. Fifty comment letters were received on the March 2006 Exposure Draft.
2. The summary of significant comments and the Task Force’s related responses, and the proposed ISA will be reviewed at the April IAASB meeting. The proposed Basis for Conclusions and proposed final ISA will be presented at the June IAASB CAG meeting, before it is approved by the IAASB in July.

#### **Significant Comments Highlighted for Consideration by the IAASB CAG**

*Audit Quality and Public Interest vs. Cost* **(See Agenda Item I.1, paragraphs 7-12)**

3. The majority of respondents to the March 2006 Exposure Draft agreed that the proposed ISA will enhance the quality of group audits and supported the specificity of the group engagement team’s procedures; however, some with qualification. Two respondents conducted informal surveys of the possible effect of the proposed ISA on the cost of group audits.
4. The Task Force, in response to requests for requirements and guidance on group audits and in light of recent financial and audit failures, has focused on developing requirements and guidance that will enhance the quality of group audits and protect the public interest. To ensure consistent application of the requirements and guidance, the Task Force believes that it is necessary to be reasonably specific about the group engagement team’s procedures.

#### **Matters for IAASB CAG’s Consideration**

Do Representatives agree with the approach explained in paragraph 4 above?

*Objective of the Standard* **(See Agenda Item I.1, paragraphs 18-20)**

5. A small number of respondents indicated support for the objective in paragraph 6 of the March 2006 Exposure Draft. Many respondents, however, were concerned about or commented on the objective. The Task Force proposes that the objective be amended to read as follows:

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“The objectives of the auditor are: (a) to determine whether to act as the auditor of the group financial statements; (b) to effectively communicate with component auditors; and (c) to obtain sufficient appropriate audit evidence about the financial information of the components and the consolidation process to express an opinion whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.” **(See Agenda Item I.2, paragraph 6)**

#### Matters for IAASB CAG’s Consideration

Do Representatives agree with the proposed objective?

*How to Define the Group Engagement Partner, Group Engagement Team and Component Auditor*  
**(See Agenda Item I.1, paragraphs 27-41)**

6. The December 2003 Exposure Draft distinguished between related auditors and other auditors. Based on responses to that Exposure Draft, the IAASB concluded that the structures of audit firms and networks vary and that it is not possible to develop a distinction between related and unrelated auditors that is capable of consistent application in all circumstances. To clarify the distinction between members of the group engagement partner’s engagement team and component auditors, the March 2006 Exposure Draft defined “group auditor” and “members of the group engagement partner’s engagement team.” Many respondents comment on these definitions.
7. The Task Force is of the view that a clearer distinction between group engagement partner and group engagement team may address some of the concerns. It therefore proposes that the definition of “group auditor” be replaced with a definition of “group engagement partner” **(see Agenda Item I.2, paragraph 8(f))** and that the definition of “members of the engagement team under the direct supervision of the group engagement partner” be replaced with a definition of “group engagement team” **(see Agenda Item I.2, paragraph 8(g))**.
8. Responsibilities (requirements) to be undertaken by the group engagement partner will be addressed to the group engagement partner. Where the group engagement team may assist the group engagement partner in fulfilling a responsibility (requirement), the responsibility (requirement) will be addressed to the group engagement team.
9. In accordance with [proposed] ISA 220 (Redrafted), the group engagement partner is required to be satisfied that those performing the group audit engagement collectively have the appropriate capabilities and competence to perform the engagement in accordance with professional standards and regulatory and legal requirements, and to enable an auditor’s report on the group financial statements that is appropriate in the circumstances. The group engagement partner is also responsible for the direction, supervision and performance of the group audit engagement. The Task Force is of the view that the requirements of [proposed] ISA 220 (Redrafted) apply regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. In the case of the

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group engagement team, or a component auditor that is from the group engagement partner's firm, the group engagement partner may be able to rely on the group engagement partner's firm's system of quality control with regard to leadership responsibilities for quality within the firm, compliance with ethical requirements, acceptance and continuance of client relationships and specific engagements, human resources, engagement performance, and monitoring (see [proposed] ISQC 1 (Redrafted)). Meeting the requirements in the proposed ISA is intended to enable the group engagement partner to meet the requirements of [proposed] ISA 220 (Redrafted) as they relate to component auditors that are not on the group engagement team or from the group engagement partner's firm. The Task Force proposes that this be explained in the Introduction section of the proposed ISA **(see Agenda Item I.2, paragraphs 2-3)**.

#### Matters for IAASB CAG's Consideration

Do Representatives agree with the proposed definitions and the approach explained in paragraph 9 above?

#### *Full vs. Divided Responsibility* **(See Agenda Item I.1, paragraphs 42-48)**

10. Responses to the March 2006 Exposure Draft indicate continued support for the proposal to eliminate the distinction between full and divided responsibility, while a small number of respondents are still of the view that there are situations in which the divided responsibility alternative is particularly useful. The Task Force considered the comments and concluded that no new arguments against the proposal to eliminate the distinction were presented.
11. Based on other comments, the Task Force developed the following new requirement: "Because the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion, the group engagement partner shall not refer to a component auditor in the auditor's report on the group financial statements." The application material explains that, although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings, conclusions or opinions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion. The group engagement partner does not, therefore refer to a component auditor in the auditor's report on the group financial statements. **(See Agenda Item I.2, paragraphs 9 and A10)**

#### Matters for IAASB CAG's Consideration

Do Representatives agree with the proposed new requirement?

#### *Acceptance and Continuance of Group Audits – Access to Information* **(See Agenda Item I.1, paragraphs 49-54)**

12. The March 2006 Exposure Draft explained that, before accepting or continuing a group audit engagement, the group engagement partner should have a reasonable expectation of obtaining

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sufficient appropriate audit evidence in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. The proposed ISA required the group engagement partner to refuse or resign from the engagement if he or she concludes that it will not be possible to obtain sufficient appropriate audit evidence, and the possible effect of this inability will result in a disclaimer of opinion on the group financial statements.

13. Some respondents were of the view that the requirement should be limited to cases where restrictions are imposed by group management. In all other cases, the group engagement partner should disclaim an opinion and explain the reason(s) for disclaiming an opinion in the auditor's report on the group financial statements. The Task Force agrees with this proposal. *(See Agenda Item I.2, paragraphs 12 and A15-A19)*

#### Matters for IAASB CAG's Consideration

Do Representatives agree with the proposal in paragraph 13 above?

#### Materiality *(See Agenda Item I.1, paragraphs 55-63)*

14. Many respondents commented on the requirements relating to materiality. Based on [proposed] ISA 320 (Revised and Redrafted), some of the Task Force members are of the view that, in the context of a group audit, three levels of materiality should be determined. That is, materiality for the group financial statements as a whole, component materiality, and amount(s) lower than component materiality.
15. Some Task Force members (and some respondents) do not agree (a) that the determination of amount(s) lower than the component materiality level should be required, or (b) that such lower amounts should be determined by the group engagement team or, where they are determined by the component auditor, that the group engagement team should determine whether they are appropriate.
16. Requirements for the three levels of materiality have been retained in the proposed ISA and are subject to decision by the IAASB *(see Agenda Item I.2, paragraphs 19-23)*. The Task Force proposes new application material to clarify the different levels of materiality and how they relate *(see Agenda Item I.2, paragraphs A39-A41)*.

#### Matters for IAASB CAG's Consideration

Do the Representatives' have views on the levels of materiality to be determined in the context of a group audit?

#### *The Group Engagement Team's Procedures in Relation to Component Auditors*

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Obtaining an Understanding of the Component Auditors *(See Agenda Item I.1, paragraphs 77-80)*

17. Many respondents to the March 2006 Exposure Draft commented on the requirements and guidance relating to obtaining an understanding of the component auditors. Based on the comments, the Task Force proposes to revise the requirement as follows: “When the group engagement team plans to request a component auditor to perform work on the financial information of a component, the group engagement team shall obtain an understanding of the following: (a) whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent; (b) the component auditor’s professional competence; (c) whether the component auditor will provide the group engagement team with the necessary access to relevant audit documentation; and (d) whether the component auditor operates in a regulatory environment that actively oversees and enforces the independence and professional competence of auditors, and the quality control systems of their firms.” *(See Agenda Item I.2, paragraph 17)*
18. To address concerns relating to the extent of evidence and documentation necessary to demonstrate compliance with the abovementioned requirement, and the effect of common quality control monitoring policies and procedures on the group engagement team’s procedures to obtain an understanding of the component auditor, the Task Force proposes to restructure and amend the application material to explain that the nature, timing and extent of the group engagement team’s procedures to obtain an understanding of the component auditor are affected by factors such as previous experience with or knowledge of the component auditor and the degree to which the group engagement team and the component auditor perform, or are subject to, common policies and procedures. *(See Agenda Item I.2, paragraphs A31-A32)*
19. The group engagement team may obtain an understanding of the component auditor in a number of ways. In the first year of involving a component auditor, the group engagement team may, for example: evaluate the results of the quality control monitoring system where the group engagement team and component auditor are from a firm or network that operates under and complies with common monitoring policies and procedures as provided for in paragraph 87 of ISQC 1; visit the component auditor; request confirmations or completion of questionnaires; or discuss the component auditor with others. In subsequent years, the understanding of the component auditor may be based on the group engagement team’s previous experience with the component auditor. The group engagement team may request the component auditor to confirm whether anything has changed since the previous year. *(See Agenda Item I.2, paragraph A33)*

#### Matters for IAASB CAG’s Consideration

Do Representatives agree with the proposals in paragraph 17-19 above?

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Involvement in the Work Performed by Component Auditors *(See Agenda Item I.1, paragraphs 81-87)*

20. Various comments were received on the requirements for the group engagement team to be involved in the work of component auditors. Based on the comments, the Task Force proposes that the actions listed in paragraph 26 of the March 2006 Exposure Draft be moved to the application material as examples of forms of involvement in the work of a component auditor. *(See Agenda Item I.2, paragraphs A49)*
21. The Task Force is of the view that, in line with ISA 315 (Redrafted), “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” and ISA 330 (Redrafted), “The Auditor’s Responses to Assessed Risks,” the group engagement team has to be involved in the risk assessment procedures that a component auditor performs on a significant component and the further audit procedures to be performed in response to identified significant risks of material misstatement of the group financial statements.
22. The Task Force therefore continues to propose that the requirements for the group engagement team to be involved in the work of a component auditor should be as follows: In the case of an audit of the financial information of a significant component, the group engagement team shall be involved in the component auditor’s risk assessment to identify significant risks of material misstatement of the group financial statements. The nature, timing and extent of this involvement are affected by the group engagement team’s understanding of the component auditor, but – at a minimum – shall include the actions listed in paragraph 27 of the March 2006 Exposure Draft *(see Agenda Item I.2, paragraph 30)*. When significant risks of material misstatement of the group financial statements have been identified in a component on which a component auditor performs the work, the group engagement team shall determine whether the further audit procedures to be performed to respond to the identified significant risks are appropriate. Based on its understanding of the component auditor, the group engagement team shall also determine whether it is necessary to be involved in the further audit procedures. *(See Agenda Item I.2, paragraph 31)*

#### Matters for IAASB CAG’s Consideration

Do Representatives agree with the proposal in paragraph 13 above?

Responsibilities of Component Auditors *(See Agenda Item I.1, paragraph 93-96)*

23. Many respondents to the March 2006 Exposure Draft continue to be concerned about the fact that the proposed ISA does not contain explicit requirements for component auditors. The Task Force is not proposing any amendments in this regard.
24. The Task Force is of the view that the relationship is between the group engagement partner and those charged with governance of the group; not between the group engagement partner and the component auditor. A requirement for the component auditor to cooperate with the

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group engagement team may have legal implications. Further, it will not be possible for the group engagement team to obtain audit evidence of a component auditor's compliance with a requirement to cooperate with the group engagement team. The group engagement team could, however, obtain an understanding (and written confirmation) whether the component auditor will provide it with the necessary access to relevant audit documentation. **(See Agenda Item I.2, paragraph 17(c))**. The Task Force is further of the view that the new objective of the auditor to effectively communicate with the component auditor will assist in this regard.

25. The Task Force proposes that the IAASB request the Ethics Standards Board for Accountants to consider whether this matter should be addressed in the *Code of Ethics for Professional Accountants*.

#### Matters for IAASB CAG's Consideration

Do the Representatives' have views on whether the proposed ISA should deal with the responsibilities of component auditors?

#### Material Presented – FOR IAASB CAG REFERENCE PURPOSES ONLY

|                 |                                                                   |
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| Agenda Item I.1 | Summary of Significant Comments on ED-ISA 600 (issued March 2006) |
| Agenda Item I.2 | Proposed ISA 600 (Revised and Redrafted)                          |

#### Action Requested

The IAASB CAG is asked to review the significant comments on ED-ISA 600 (issued March 2006) highlighted in this paper, and to comment on the Task Force's proposed responses.