

Meeting: IAASB Consultative Advisory Group (CAG)

Meeting Location: New York, United States of America

Meeting Dates: September 10–11, 2019

Agenda Item

K

ISA 600, *Special Considerations—Audits of Group Financial Statements* (Including the Work of Component Auditors)

Objective of Agenda Item

1. The objective of this agenda item is to
 - a) Report back on the IAASB CAG representatives' comments on the project to revise ISA 600¹ made at the March 2019 meeting.
 - b) Update the Representatives on the work performed by the Group Audits Task Force (the Task Force) since the March 2019 meeting and to obtain the Representatives' views on proposed changes to ISA 600.

Project Status

2. Since the March 2019 IAASB CAG meeting, the Task Force further discussed the issues that had been identified in the Invitation to Comment (ITC)² and the comments from respondents on the ITC. The Task Force also started to draft certain sections of proposed ISA 600 (Revised).
3. For the June 2019 IAASB meeting, the Task Force prepared preliminary drafting on certain key sections and for the September 2019 IAASB meeting the Task Force will present drafting for a significant portion of the standard. In addition, several key issues have been discussed with the Board (in the June 2019 meeting) or will be discussed in the September 2019 meeting.
4. The Task Force is working towards an approval of the exposure draft of proposed ISA 600 (Revised) at the March 2020 IAASB meeting and aims to have a full draft of the standard available for discussion at the December 2019 meeting.
5. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and IAASB on ISA 600, including links to the relevant IAASB CAG documentation.

IAASB CAG Discussion in September 2019

6. For the purposes of the IAASB CAG discussion, the following has been provided to the Representatives:

¹ International Standard on Auditing (ISA) 600, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

² <https://www.ifac.org/publications-resources/invitation-comment-enhancing-audit-quality-public-interest>

- *Presentation*—The presentation slides will be used to guide the discussion during the meeting and include the key matters that the Task Force would like to highlight to the Representatives (**Agenda Item K.1**).
 - *Issues Paper*— The issues paper is the same as the paper that will be presented to the IAASB for the September 2019 meeting (**Agenda Item K.2**). The issues paper includes the Task Force's thinking on some key matters, including the key public interest issues to be addressed, the scope and structure of the standard and some issues for discussion with the Board.
7. For the purposes of the IAASB CAG discussion, the Representatives are requested to focus on the following matters:
- Presentation (**Agenda Item K.1**);
 - Issues paper (**Agenda Item K.2**), the following areas only:
 - Section I: Public Interest Issues;
 - Section II: Scope and Structure of the Standard, Including Special Considerations in a Group Audit;
 - Access to People and Information at the Component Level, which is included in section III;
 - Materiality Considerations in a Group Audit, which is included in section IV; and
 - Section VI: Way Forward.
 - **Appendix B** to this agenda item. At the March 2019 meeting, the IAASB CAG discussed the Task Force's initial views on the approach to scoping a group audit (at that time it was referred to as the 'top-down approach,' and is now referred to as the 'risk-based approach'). **Appendix B** includes the risk-based approach section of the issues paper that was discussed with the IAASB in June 2019. In the June 2019 meeting, the Board generally agreed with the Task Force's approach as set out in in **Appendix B** and, based on that feedback, the Task Force developed the drafting that will be discussed by the Board in the September 2019 meeting (see reference papers).
8. When navigating the issues paper (**Agenda Item K.2**), Representatives are requested to ignore the 'Matters for IAASB Consideration' as the paper is an IAASB Board paper. The questions that are being asked of the Representatives are outlined below.
9. The matters in paragraph 7 will be discussed in the same order as presented in **Agenda Item K.1**.

Matters for IAASB CAG Consideration

Public Interest Issues

1. The Representatives are asked for their views on the enhanced public interest issues.

Risk-Based Approach to Planning and Performing a Group Audit

2. The Representatives are asked for their views on the Task Force's description of the risk-based approach to planning and performing an audit of group financial statements.

Scope and Structure of the Standard

3. The Representatives are asked for their views on the Task Force's proposals on the scope and structure of the standard, including the special considerations as set out in paragraph 10–23 of **Agenda Item K.2**.

Access to People and Information at the Component Level

4. The Representatives are asked for their views on how the Task Force has addressed the issues related to access to people and information, including whether there are any access issues other than those described in paragraph 25 of **Agenda Item K.2**.

Materiality Considerations in a Group Audit

5. The Representatives are asked for their views on the Task Force's initial thinking and recommendations with respect to the materiality considerations in a group audit.

Way Forward

6. The Representatives are asked whether there are any other matters they would like to bring to the attention of the Task Force.

Feedback

10. Extracts from the draft March 2019 IAASB CAG meeting minutes, as well as an indication of how the Task Force or IAASB has responded to the Representatives' comments, are included in the table below.

Representatives' Comments	Task Force/IAASB Response
SCOPING A GROUP AUDIT	
Mr. Dalkin supported the Task Force's proposals to focus on the risks of material misstatement in scoping a group audit (also referred to as the 'top down approach') instead of the identification of components. He noted that auditors focus too much on the identification of significant components and should focus more on addressing the identified risks of material misstatement. This approach would be more aligned to the approach required by ISA 315 (Revised). ³ Messrs. Hansen, Thompson, and Hirai and Ms. Zietsman agreed.	Support noted. The Task Force further developed its proposals to focus on the risks of material misstatement of the group financial statements in planning and performing a group audit.
Ms. Zietsman noted that the PCAOB has a project to revise its group audits standard as well and that	Point noted.

³ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

Representatives' Comments	Task Force/IAASB Response
the PCAOB's staff is working on a recommendation on the way forward. She explained that the direction taken by the PCAOB is similar to the direction proposed by the ISA 600 Task Force as it on understanding the component auditor, focuses on proper supervision, direction and review and highlights the importance of the group engagement team's involvement. In addition, she noted that the PCAOB's standard also focuses on risks instead of components. She added that focusing on components has helped firms build their methodologies, but that today's world is different and that an approach that focuses on risks makes more sense.	Since the March 2019 IAASB CAG meeting the Task Force met once with representatives of the PCAOB to discuss the way forward on ISA 600 (Revised).
Mr. Hirai noted that the 'top down approach' may not work well in situations where the component auditor has influence over the conduct of the group audit because the component is very material to the group audit. Mr. Yoshii questioned whether the 'top down approach' will work as it may be hard to identify where the risks of material misstatement are in a group. He highlighted that it is important to focus on the entity's corporate governance as well.	Point noted. With respect to the situation where the component auditor holds a lot of power, Mr. Jui noted that the group auditor signs the opinion and should therefore be responsible for the group audit and that the ISA 600 Task Force will look into the issue, leveraging off the requirements in ISA 220 (Revised). ⁴
Mr. Fortin suggested not to use the term 'top-down approach' as this term does not clearly describe the approach suggested by the ISA 600 Task Force and might be seen by component auditors as putting them in a subservient role.	Point accepted. The Board raised similar concerns so the Task Force now refers to this approach as the "risk based approach" because the foundation for planning and performing the group audit rests in ISA 315 (Revised) and ISA 330.
OTHER MATTERS	
Mr. Dalkin questioned whether an auditing standard on group audits is needed given the revisions to the quality management standards and ISA 315 (Revised).	Point noted. Mr. Jui explained that the principles for a group audit may be included in other ISAs but that the auditor should consider additional matters in a group audit, for example, scoping the group audit,

⁴ Proposed ISA 220 (Revised), *Quality Control for an Audit of Financial Statements*

Representatives' Comments	Task Force/IAASB Response
	<p>communication with component auditors and the assessment of relevant ethical requirements.</p> <p>Agenda Item K.1 section II describes the scope of the standard and the special considerations in a group audit.</p>
<p>Ms. Manabat noted several matters that make a group audit complex that should be considered by the Task Force, including the use of shared service centers, the use of technology, use of another auditor's report and non-controlled entities.</p>	<p>Point noted.</p> <p>Mr. Jui noted that the ISA 600 Task Force will consider these matters.</p> <p>The Task Force has discussed several of the topics mentioned and will continue to further develop its thinking on these matters.</p>
<p>Mr. Hansen highlighted the importance of considering relevant ethical requirements in a group audit engagement and supported liaising with International Ethics Standards Board for Accountants (IESBA). Ms. Manabat agreed.</p>	<p>Point noted.</p> <p>The Chair and staff of the ISA 600 Task Force meet regularly with representatives of IESBA, for example to discuss on the definition of 'engagement team' and on other matters on which liaison is needed.</p>
<p>Mr. Hansen questioned how a group auditor should deal with independence when the group auditor is different than the component auditor.</p>	<p>Point noted.</p> <p>Mr. Jui noted that the ISA 600 Task Force will consider this issue as part of this project.</p> <p>As noted above, the Task Force will continue to liaise with IESBA on this matter.</p>
<p>Mr. Thompson noted that setting component materiality, including how to deal with aggregation risk, is a major issue in practice. He noted that further guidance is needed to address the inconsistencies and reduce the confusion.</p>	<p>Point noted.</p> <p>Mr. Jui noted that the Task Force identified this issue and plans to address this matter.</p> <p>Agenda Item K.1 (section IV) includes the Task Force's initial thinking on component materiality. Further work will be performed to address this matter.</p>
<p>Mr. Dalkin noted that the communication between the group auditor and the component auditor is too formalized and is more focused on the mechanics than the risks. Messrs. Ruthman and Hirai agreed. Mr. Hirai highlighted the importance of two-way communication between the group auditor and the</p>	<p>Point noted.</p> <p>Mr. Jui noted that this is one of the issues that the ISA 600 Task Force will address.</p> <p>The Task Force had preliminary discussions on this matter and will continue to address it.</p>

Representatives' Comments	Task Force/IAASB Response
component auditor and that the component auditor also needs to proactively communicate with the group auditor.	
Mr. Hirai noted the importance of the group auditor's involvement in the component auditor's work and questioned whether the engagement quality reviewer at a group level should monitor the work of the component auditor and communicate with the component auditor.	Point noted. The Task Force had preliminary discussions on this matter and will continue to address it.
Mr. Fortin noted that the revised standard should address the interactions between the group auditor and the statutory auditor as well as it affects how audits are performed. He noted that stakeholders such as the Basel Committee and IFEI can provide the ISA 600 Task Force with input on this matter.	Point accepted. Mr. Jui noted that the Task Force plans to reach out to various stakeholders to obtain their input. The Task Force has proposed additional application material on this matter (Paragraph A47H).
Mr. Hansen noted that the situation where a group auditor is also a component auditor is confusing and suggested clarifying this situation.	Point noted.
Mr. Hansen noted that the access to documentation seems to be a political issue and questioned whether standard-setting could solve this issue. Instead, he was of the view that the access to documentation should be solved on a national level.	Point noted. Mr. Jui noted that group management has access to all documentation for the group financial statements and that auditors should also have access to all information. He added that regulators see this as an important issue as well and that they support addressing it in the revisions of ISA 600. The Task Force proposes several changes to the application material to address access issues. See Agenda Item K.1 , section III.
Mr. Hansen noted that some stakeholders question whether a group auditor has done enough work to sign the auditor's report as the majority of the audit work may have been performed by another auditor.	Point noted. Mr. Jui explained that the IAASB issued a staff audit practice alert on the responsibilities of the engagement partner in circumstances when the engagement partner is not located where the majority of the audit work is performed and that the PCAOB issued a practice note on this matter. He added that proposed ISA 220 (Revised) also

Representatives' Comments	Task Force/IAASB Response
	addresses the issue as it relates to whether or not the engagement partner has been sufficiently and appropriately involved in the audit to be able to take responsibility for managing and achieving quality on the engagement, but that the ISA 600 Task Force will consider making changes to ISA 600 to address this matter more specifically in the context of group audits.

Material Presented – IAASB CAG Papers

Agenda Item K.1 Presentation

Agenda Item K.2 IAASB Issues Paper

Material Presented – IAASB CAG Reference Paper

Agenda Item 9-A for the September 2019 IAASB Meeting – Discussion of Significant Changes to Requirements and Application Material https://www.iaasb.org/system/files/meetings/files/20190916-IAASB-Agenda_Item_9A-Discussion_of_Significant_Changes_to_Requirements_and_AM-Final.pdf

Agenda Item 9-B for the September 2019 IAASB Meeting – ISA 600 — Drafting (Clean) https://www.iaasb.org/system/files/meetings/files/20190916-IAASB-Agenda_Item_9B-ISA_600_Clean-final.pdf

Appendix A

Project History

Project: ISA 600

Summary

	IAASB CAG Meeting	IAASB Meeting
Project Commencement	March 2015 September 2015 September 2016	December 2014 March 2015 June 2015 September 2015 December 2015 June 2016 September 2016
Project Proposal	November 2016 Teleconference	December 2016
Discussion of issues	March 2017 September 2017 March 2019	June 2017 September 2017 December 2017 March 2019 June 2019

IAASB CAG Discussions: Detailed References

Project Commencement	<u>March 2015</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item B). http://www.ifac.org/meetings/new-york-usa-5 <u>September 2015</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item F). http://www.iaasb.org/cag/meetings/new-york-usa-0 <u>September 2016</u> See IAASB CAG meeting material (Agenda Item G).
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	http://www.iaasb.org/cag/meetings/new-york-usa
Project Proposal	<p><u>November 2016</u></p> <p>See IAASB CAG meeting material (Agenda Item B).</p> <p>www.iaasb.org/cag/meetings/iaasb-cag-conference-call-november-29-2016-730-am-1030-am-est</p>
Issues Discussion	<p><u>March 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item H).</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p> <p><u>September 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item G).</p> <p>http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p> <p><u>March 2019</u></p> <p>See IAASB CAG meeting material (Agenda Item C)</p> <p>https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1</p>

Appendix B

Extract from June 2019 Issues Paper⁵

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Section II: Risk-Based Approach to Planning and Performing a Group Audit

Background

5. The Task Force discussed with the IAASB at its March 2019 meeting that the approach in extant ISA 600 may not result in the auditor developing the most appropriate procedures / responses to the risks of material misstatement of the group financial statements, including the determination of components where procedures need to be performed to obtain audit evidence to support the opinion on the group financial statements. Accordingly, enhancements to ISA 600 would include:
- Greater alignment with the requirements in ISA 315 (Revised) and ISA 330;
 - A greater focus on the group engagement team's responsibility, with the assistance of component auditors⁶ as needed, to:
 - Assess the risks of material misstatement at the group financial statement level and assertion level for the group financial statements, and
 - Determine the nature, timing and extent of planning further audit procedures, as determined under ISA 330; and
 - A greater focus on planning the most appropriate approach to obtaining sufficient appropriate audit evidence (i.e., not just defaulting to "an audit" of the component financial statements). The auditor's focus should be on whether and how the assessed risks are addressed through work performed at the group level by the group engagement team or through work performed at the component level, including by component auditors.
6. The IAASB supported the Task Force's further development of this approach. However, concerns were expressed about calling it a "top-down" risk-based approach, as this may imply that the identification, assessment and response to the risks of material misstatement of the group financial statements is done by the group engagement team without input, when and to the extent necessary, from component auditors with respect to certain components. It was suggested that the approach be described as a "group engagement team led risk-based approach." The Task Force agrees that the contemplated approach should be driven by the group engagement team, but believes it would be simpler to refer to it as a "risk-based approach" because the foundation to planning and performing the group audit rests in ISA 315 (Revised) and ISA 330.

Risk-Based Approach Explained

7. The ISAs require the auditor to understand the entity and its environment, the applicable financial reporting framework and the entity's system of internal control, and to identify, assess and respond to risks of

⁵ https://www.iaasb.org/system/files/meetings/files/20190617-IAASB_Agenda_Item_6-ISA-600-Issues-Paper-final.pdf

⁶ The Task Force had preliminary discussions about whether the term "component auditors" could be replaced with "other auditors." For the purposes of this paper and the indicative drafting, the Task Force has retained the term "component auditor."

material misstatement. In a group audit, the group engagement team may not be able to obtain sufficient audit evidence (for example, when components are located in different geographical locations) and therefore may use component auditors to obtain audit evidence.

8. The risk-based approach can be characterized as thinking about what, how and when, by whom and where, for example:
- What – identifying the significant accounts, classes of transactions or disclosures in the group financial statements, and the breakdown of account balances and classes of transactions by component, to identify and assess risks of material misstatement of the group financial statements at the account and assertion levels;
 - How and when – determining the most appropriate audit strategy (e.g., centralized testing when appropriate) and the nature, timing and extent of procedures to address the assessed risks of material misstatement of the group financial statements; and
 - By whom and where – determining whether the group engagement team or component auditors will obtain the audit evidence, and where procedures need to be performed to obtain audit evidence, in response to the assessed risks of material misstatement.

Obtaining an Understanding of the Entity and Its Environment and the Entity's System of Internal Control

9. The foundation of the risk-based approach is the group engagement team's understanding of the entity and its environment, including the system of internal control, in accordance with ISA 315 (Revised). Special considerations in applying ISA 315 (Revised) to an audit of group financial statements primarily relate to, and are focused on, the additional considerations and complexities faced by a group engagement team when auditing an entity that includes more than one component, for example:
- The understanding of the entity and its environment is often more complex due to the wide variety of group structures, and businesses that may exist across multiple geographical locations or jurisdictions. The way the group is managed may also add complexities, particularly if there are multiple lines of business, which may be in different industries (e.g., a captive insurance company for a manufacturing entity).
 - In connection with understanding the information system relevant to financial reporting:
 - In a group, there may be multiple information systems, or the information systems may be centralized.
 - It is more likely that shared service centers may be used in a group environment.
 - Paragraph 35(c) of the exposure draft of proposed ISA 315 (Revised)⁷ requires the auditor to obtain an understanding of the financial reporting process used to prepare the entity's financial statements. In an audit of group financial statements, the consolidation process is an important part of the financial reporting process, and likely would require additional audit effort when the consolidation process is more complex due to a significant amount of intercompany transactions or elimination entries, or when the group uses consolidation

⁷ <http://www.ifac.org/system/files/publications/files/Proposed-ISA-315-Revised-Explanatory-Memorandum.pdf>

software (e.g., Hyperion) that interfaces with multiple general ledger systems from different business units.

10. When dealing with different structures, businesses and information systems, the group engagement team may need to involve component auditors to assist in obtaining the understanding required to identify and assess risks of material misstatement, including, as appropriate, performing risk assessment procedures at one or more components.
11. Because of the above, the Task Force is of the view that the special considerations related to understanding the entity and its environment and the entity's system of internal control are:
 - The group's organizational structure, ownership and governance;
 - The group's business model;
 - The design and implementation of controls over the group's information system; and
 - The accounting policies and practices used by the group.
12. The Task Force will further discuss and develop the special considerations related to the understanding the entity and its environment and the entity's system of internal control.

Identifying, Assessing and Responding to the Risks of Material Misstatement

13. As noted in paragraph 5 above, scoping a group audit based on the identification of components (and identification of those that are significant) will not always result in an appropriate approach to the identification and assessment of the risks of material misstatement at the group financial statement level, and the planning and performance of appropriate procedures to respond to those risks.
14. For example, the requirement to perform an audit of financial information at significant components may not appropriately focus the work of a component auditor on risks of material misstatement of the group financial statements that need to be addressed (i.e., particularly when the risks of material misstatement related to individual components' financial information vary in nature, type and significance). Also, the current approach can be interpreted to allow for focusing the audit effort on significant components with little or no additional audit work done on the remaining components.
15. The Task Force is of the view that a risk-based approach to planning and performing a group audit is more appropriate as it better focusses the group engagement team on identifying the significant accounts, classes of transactions or disclosures in the group financial statements, and the related risks of material misstatement. This approach will more closely align ISA 600 with the principles in ISA 315 (Revised) and will address some of the challenges and concerns raised in response to the Invitation to Comments (ITC).⁸
16. Under the risk-based approach, the group engagement team is responsible for the identification, assessment and responses to the risks of material misstatement. However, this does not mean that the group engagement team cannot involve component auditors to assist with the risk assessment. The Task Force is of the view that the involvement of component auditors to assist in performing risk assessment procedures at one or more components may be appropriate depending on the facts and circumstances. For example, component auditors may have greater knowledge of local jurisdictional matters that may

⁸ <https://www.ifac.org/publications-resources/invitation-comment-enhancing-audit-quality-public-interest>

give rise to a risk of material misstatement at the group financial statement level. Also, as noted in paragraph 9 above, one or more components may be in different lines of business or industries.

17. After the group engagement team has assessed the risks of material misstatement at the group financial statement level, with the assistance of component auditors as needed, the group engagement team needs to determine the most appropriate strategy and the nature, timing and extent of procedures to address the assessed risks of material misstatement in accordance with ISA 330. The group engagement team considers the most effective and efficient responses to the assessed risks, which may involve obtaining audit evidence in different ways. For example, planning and performing audit procedures related to litigation and claims might be done by the group engagement team on a group-wide basis because this area is managed centrally by the entity, even though component financial information may also include disclosures related to litigation and claims.
18. The group engagement team also needs to determine who will obtain the audit evidence in response to the assessed risks of material misstatement. The decisions about who will obtain the audit evidence, and when this should be done, depend on the facts and circumstances—it may be the group engagement team itself or it may be a component auditor. Factors that may be relevant in making this decision, include, for example:
 - The competency and capabilities of the component auditor;
 - Whether an audit is required at the component level by statute, regulation or for another reason; and
 - Whether there is an internal audit function that, for example, monitors the system of internal control.

Evaluating the Work of Component Auditors and Sufficiency and Appropriateness of Audit Evidence Obtained

19. The Task Force also discussed enhancing the 'stand-back' requirements in extant ISA 600 by requiring the auditor to evaluate whether there are any financially significant components or material account balances on which no further audit procedures were performed.

Key Similarities and Changes

Similarities

20. The risk-based approach to planning and performing a group audit has a different focus than the approach in extant ISA 600, but many of the underlying concepts remain the same. For example:
 - The objective of an audit of group financial statements remains to obtain sufficient appropriate audit evidence to provide a basis for expressing an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
 - Understanding the entity and its environment remains a fundamental part of the standard.
 - The communications with and the involvement of component auditors. Two-way communication between component auditors and the group engagement team throughout the audit remains critically important under the risk-based approach. The involvement of component auditors also remains very important throughout a group audit engagement, including in performing the risk

assessment procedures if directed by the group engagement team, and in identifying, assessing and responding to the risks of material misstatement, when appropriate.

Changes

21. As described earlier in this section, the new risk-based approach aligns ISA 600 closer to the approach in ISA 315 (Revised) by focusing on identifying and assessing risks at the group level and determining that the planned scope of work appropriately responds to those risks, rather than the current approach whereby the scope of the work is driven primarily by the identification of components and determination of their significance.
22. Given the focus on significant classes of transactions, account balances and disclosures in the group financial statements, and the identification and assessment of risks of material misstatement at that level, instead of the identification of components, there may be no need to retain a requirement to identify components that are significant. The Task Force believes that the proper application of the risk-based approach will result in appropriate procedures being performed on significant account balances, classes of transactions, and disclosures at locations that would be considered significant due to size or risk under extant ISA 600. However, the Task Force recognizes that in some instances it may still be useful to identify components that are significant due to their financial significance and will add application material in that regard in the standard.

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