Group Audits – Issues and Working Group Recommendations

Objectives of the Discussion

The objective of the discussion is to obtain Board input on the matters addressed herein to inform the development of the group audit-related content of the Discussion Paper (DP) by the Group Audits Working Group (GAWG), through:

(a) Obtaining further input about the issues that have been raised relating to audits of group financial statements, taking into account existing requirements and guidance in the International Standards on Auditing (ISAs), and including input as to whether there are other issues not summarized herein; and

(b) Discussing Board views on the matters set forth herein, including the GAWG’s preliminary views on possible ways to address the relevant issues.

In particular, IAASB views on the topics within this paper will be used by the GAWG as the basis for:

- How group-audit related matters will be described in the DP; and
- Developing the questions for respondents to be included in the DP.

March 2015 Group Audits [Draft] Minutes

The Board generally supported soliciting further input on the Group Audits project by means of a DP. Specifically, the Board:

- Suggested that consideration of the results of academic research should be considered in drafting the DP.
- Recommended considering the impact of relevant accounting standards (i.e., those that have a direct impact on entities that are considered groups), as well as monitoring the results of developments in the accounting standards, and considering the impact that these developments may have on the audits of group financial statements.
- Raised the issue of the ability of the auditor of the group financial statements to more directly use or rely on a component auditor’s report, including making reference to such report in the group auditor’s report. Discussed that the Group Audit WG might potentially consider exploring the issue further (including analyzing the related issues and considering what might be an appropriate the level of work to be performed by the group auditor in such circumstances), and seek further input in the DP.
- Recommended that the Group Audit WG continue to focus its information gathering on understanding the root cause of inspection findings and on formulating preliminary views as to whether issues that have been noted might be best addressed through standard setting or whether they are more related to auditor performance.
- Cautioned against the potential of diminishing the auditor’s responsibilities with respect to group audits, noting the requirement to obtain a reasonable level of assurance to support the opinion on the group financial statements, which is considered to be a high level of assurance.
- Considered whether it might be useful to provide examples of how group audit issues could
become key audit matters (KAM) to be communicated in the auditor’s report in accordance with ISA 701.¹

Board members expressed mixed reactions to the proposal for a Staff document to be prepared to specifically address the issues that have been raised by certain audit regulators in respect to “audits of letterbox companies”, noting in particular that the issues relating to such audits are complex and that they are not necessarily unique to these audits, but rather are issues that have broader applicability to many other group audit situations. The Board also suggested that a different term should be used to describe the audits that are the subject of the regulator’s concerns, given the inconsistency in the understanding of the term “audits of letterbox companies” and the perceived negative connotations. On balance however, the Board understood the need for a shorter-term action, and supported the WG’s recommendation to develop a brief Staff publication to remind auditors of their obligations in these circumstances and also indicate that a broader project is underway. Some members cautioned that:

- Care would be needed to ensure that the staff document did not result in an interpretation of the existing standards that would go beyond just reminding auditors of the existing requirements and guidance.
- A staff alert may have little value and could run the risk of creating more issues in the area of group audits.

The Board agreed that issues pertaining to “audits of letterbox companies” apply more broadly to group audits and should be explored in more detail in the planned DP, which would provide the opportunity for the complexities to be fully identified and understood.

IAASB CONSULTATIVE ADVISORY GROUP (CAG) CHAIRMAN’S REMARKS

Ms. de Beer noted the CAG was supportive of the proposed approach for the Group Audits project, including the proposal to publish a Staff document reminding auditors what is required by the ISAs in situations where the engagement partner is located in a different location than where the work is being performed, noting that inconsistent practices in the application of the ISAs in these situations could be damaging to the reputation of the ISAs. She noted the CAG’s discussions focused on the difficulties of identifying components in the public sector, issues with access to component auditor working papers and issues with the determination of component materiality. Ms. de Beer also noted that the CAG had recommended consideration of the results of academic studies in determining the population of group audit issues.

WAY FORWARD

Staff, in coordination with the WG, will develop a draft Staff publication on the topic of audits of letterbox companies to clarify the application of the ISAs in such situations. The Group Audit WG will continue to explore and understand the issues pertaining to group audits, incorporating the feedback from the Board and the CAG, and present further matters for the IAASB’s consideration at its June 2015 meeting.

Background

1. The International Auditing and Assurance Standards Board’s (IAASB) Strategy for 2015–2019 acknowledges the IAASB’s strong commitment to meeting the expectations of stakeholders regarding the application of the ISAs. Accordingly, the IAASB has agreed to focus on certain ISAs in 2015–

¹ ISA 701, Communication of Key Audit Matters in the Independent Auditor’s Report
2016, including planned efforts on group audits that commenced with forming a Working Group in 2014 (the GAWG).

2. The GAWG commenced its work and held an initial discussion with the Board at its March 2015 meeting about issues and concerns that have been identified related to the implementation and use of ISA 600\(^2\) in group audits and the history of the development of ISA 600, including significant decisions that were made in revising and redrafting the standard during the clarity project. Separately, the GAWG has also held two discussions with the Board on the topic of “audits of letterbox companies” (at the December 2014 and March 2015 Board meetings). See Agenda Item 6 for further discussion of the GAWG’s activities related to this topic. The GAWG has developed this paper to describe its further analysis of the issues related to ISA 600 and to provide its views on the way forward.

3. At the March 2015 meeting, the IAASB agreed with the GAWG’s proposal that formal public consultation on the matters identified relating to group audits would be appropriate in order to inform a future project proposal to amend the ISAs. In addition, the IAASB concurred that a DP was an appropriate mechanism for performing this public consultation. The DP will contain a description of issues identified, together with the IAASB’s views about how the issues might best be addressed, including whether and if so, how the requirements and guidance in the ISAs should be amended. The objective of this public consultation, using the DP as a means of communication to interested stakeholders (see further information about the DP in Agenda Item 8), will be to:

- Confirm that the issues identified in the DP are complete, including that all relevant aspects of those issues have been highlighted and obtain views about the relative significance or importance of the issues with respect to their effect on audit quality.
- Obtain input about the IAASB’s views as to how the issues could be addressed effectively, including through changes to the standards or through other appropriate action by the IAASB or other stakeholders.\(^3\) Input requested would include stakeholder views as to:
  
  (i) Whether the issues identified apply equally to all entities (i.e., entities of different sizes and complexity, different industries, and across jurisdictions), or whether there are specific considerations for particular circumstances (e.g., an issue may be identified as specific to a particular type of entity or may be more acute within a particular jurisdiction).
  
  (ii) The appropriateness of the proposed actions, including whether alternative actions should be considered. If the proposed actions to address issues identified are not within the IAASB’s mandate, stakeholder views about those actions that may be appropriate for someone other than the IAASB could also be solicited, including views about the role that the IAASB might play with respect to such actions.

As described in Agenda Item 8, the DP will contain specific questions related to Group Audits. The responses to the DP in general, as well as the GADP, will assist the IAASB in developing the project proposal relating to group audits (and other projects as relevant), specifically informing the areas to

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\(^2\) ISA 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

\(^3\) The IAASB may also consider those matters that will require collaboration or cooperation with other stakeholders for an effective solution and engage with them as relevant.
be pursued (see further discussion about potential actions that the IAASB may undertake in paragraphs 22–23).

Introduction

4. In commencing its discussions and analysis of the issues related to group audits, the GAWG notes that when planning and performing an audit of group financial statements, the nature, timing and extent of the audit work required and the nature of the judgments involved will vary, potentially significantly, given the wide variety and complexity of the way in which entities producing group financial statements are structured. The assessment of what comprises “sufficient appropriate audit evidence” in the circumstances will therefore likely be a matter involving the exercise of significant professional judgment, reflecting the nature and complexity of the entity, as well as the auditor’s identification and assessment of the risks that the group financial statements prepared by management could be materially misstated, and the auditor’s assessment as to whether sufficient appropriate audit evidence can be reasonably expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the audit opinion. This will also include the auditor’s determination that such risks have been properly addressed by the audit evidence obtained. Perspectives of different stakeholders about the sufficiency and appropriateness of audit evidence in certain group audit situations may therefore vary.

5. In order to facilitate the development of the GADP, the GAWG has considered issues that have been identified relating to audits of group financial statements, predominantly those identified by the IAASB’s ISA Implementation Monitoring project and from outreach with stakeholders, including regulators and audit oversight bodies and firms.

6. The IAASB’s Framework for Audit Quality sets out the interactions of the various elements for planning and performing a “quality audit” using principles-based standards. In this context, there are many variables which can lead to a breakdown in audit quality in an audit performed in accordance with the ISAs – ranging from the performance (or lack thereof) of auditors, to contextual factors (including the clarity and robustness of the ISAs). In order to obtain a thorough understanding of the issues that have been identified as impacting the audit quality of group audits and as a basis for formulating preliminary views on how such issues might be addressed, the work of the GAWG to date has included identifying and attempting to obtain an understanding of the causal factors underpinning the issues that have been identified. This understanding is intended to assist the GAWG in identifying, on a preliminary basis, what might be appropriate action(s) to address the issues identified. In some cases, more information gathering will be necessary to further understand the issues.

7. To enhance the value of the input that will ultimately be received in response to the GADP, it is very important that the issues are well described so that respondents are appropriately informed when providing their input.

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4 The IAASB’s Work Plan for 2015–2016 identified Group Audits as a priority project in the 2015–2016 period. It was agreed that the individual working groups would more fully consider the underlying issues and recommend further actions for the IAASB’s consideration. The DP will be used as part of the GAWG’s considerations about future potential actions to recommend.

5 See the final report on the findings from the IAASB’s post-implementation review here.
Overarching Issues

Applicability of the ISAs

8. As further information is gathered, and changes to ISA 600 (and potentially other ISAs) are contemplated, the GAWG will be mindful of emphasizing the application of the relevant ISAs when performing audits of group financial statements.

9. As highlighted in the Introduction to ISA 600, paragraph 1, and the [Draft] Staff Audit Practice Alert (see Agenda Item 6) (Staff Alert), all of the ISAs (including ISA 2206) apply to all audit engagements that are conducted in accordance with the ISAs, and ISQC 17 applies to all firms conducting these engagements.8 ISA 600 was developed to assist auditors with applying the requirements of the ISAs in group situations and accordingly sets out the special considerations that apply to group audits, in particular those that involve component auditors.

10. Audits are adapted according to the facts and circumstances of each audited entity, and the nature, timing and extent of involvement or use of other auditors may vary for each group entity. The auditor is obliged to comply with the requirements and guidance in ISA 600 when the audit meets the definition of a group audit in ISA 600 (i.e., a group audit9). Even if an audit is not a group audit, there may be circumstances when performing the engagement includes involving other auditors. Although ISA 600 does not apply to these situations, paragraph 2 of ISA 600 indicates that “the auditor may find this ISA, adapted as necessary in the circumstances, useful when that auditor involves other auditors in the audit of financial statements that are not group financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location.” As part of the considerations to revise ISA 600, the GAWG believes it may be useful to clarify paragraph 2 by explaining when ISA 600 could be applied to audits that are not group audits and how it could or should be applied.

Auditor Performance Issues and the Role of Audit Documentation

11. The GAWG notes that the concerns of audit regulators are based on inspection findings related to auditor performance issues. In its deliberations, the GAWG has however been mindful of, and alert to, the possibilities that some auditor performance issues may be addressed through clarification or strengthening of existing requirements or guidance; however the GAWG notes that not all issues are necessarily capable of being addressed through standard setting or through standard setting alone.

12. Reflecting on all of the issues that have been highlighted, the GAWG has considered that inadequate audit documentation may be a contributing factor, or may be the basis for some of the issues and concerns noted. Inadequate audit documentation may result from an auditor performance issue (i.e.,

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6 ISA 220, Quality Control for an Audit of Financial Statements
7 International Standard on Quality Control (ISQC) 1, Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements
8 The [draft] Staff Alert was developed to remind readers of the application of the ISAs, including ISA 220, to situations where the engagement partner is in a certain location, but all of the general and financial management and most of the business activity is undertaken elsewhere, and where more than one auditor is involved. These situations may be group audits, but might also be audits of entities that do not prepare consolidated financial statements.
9 A group audit is defined as “the audit of group financial statements” (ISA 600, paragraph 9(f)). A group is defined as “all the components whose financial information is included in the group financial statements. A group always has more than one component” (ISA 600, paragraph 9(e)).
failing to prepare documentation that complies with the requirements of the ISAs) 10 or may be due to the specific documentation requirements in the ISAs (including ISA 600) not being sufficiently robust, or may be a combination of these two factors. Accordingly, as each issue was debated by the GAWG, consideration was given to the possibility that the issue may, at a minimum, be the result of inadequate audit documentation being included in the audit file, which may suggest that further consideration should be given to strengthening the documentation requirements relating to group audits, both generally and in relation to some specific areas (as explained in the tables below).

Crossover Issues with Other IAASB Projects

Quality Control

13. In some cases, although primarily identified as an issue relating to group audits, certain issues may also have aspects relating to other ISAs that may be more appropriately addressed in those ISA(s) rather than in ISA 600. For example, although aspects of the issue of alternative audit delivery models (sometimes referred to as ‘outsourcing’ or ‘distributed engagement teams’) may relate to group audits, the issues raised would also relate to audits of financial statements that are not group financial statements. This would appear to more fundamentally address the quality control aspects of the audit (i.e., direction, supervision, performance and review) and therefore might be better addressed in ISA 220. The GAWG will therefore continue to work closely with the Quality Control Working Group (QCWG) in formulating the most appropriate way forward on the crossover issues that have been identified.

Disclosures in the Group Financial Statements

14. In the recently completed Disclosures project, it was identified that the ISAs needed to specifically address the group engagement team’s considerations of the impact of component financial statement information on the disclosures in the group financial statements (i.e., that ISA 600 needed to be strengthened in this regard). As the project proposal for addressing issues identified in group audits is developed from the responses to the GADP, consideration will be given to the need to specifically address consideration of group financial statement disclosures in all aspects of ISA 600 (i.e., in a similar approach to how changes to the ISAs were considered during the Disclosures project).

Professional Skepticism

15. The findings from the IAASB’s ISA Implementation Monitoring project and inspection reports from audit regulators include identified issues about the level, and consistency, of professional skepticism and professional judgment being applied in audits; and about the documentation of the auditor’s considerations around professional skepticism and professional judgment relative to the sufficiency and appropriateness of audit evidence being obtained to support the auditor’s opinion on the financial statements. A Working group to explore the topic of Professional Skepticism has been set up, with a panel discussion on professional skepticism planned for the June 2015 IAASB meeting (see Agenda Item 10). The GAWG’s work will include consideration of the activities and outputs from the Professional Skepticism Working Group.

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10 In addition to the specific documentation requirements in paragraph 50 of ISA 600, any audit performed using the ISAs would also need to comply with the documentation requirements in ISA 230, Audit Documentation, which deals with the auditor’s responsibility to prepare audit documentation for an audit of financial statements.
16. The IAASB’s *Framework for Audit Quality* emphasizes that professional skepticism is an attitude that includes the application of a questioning mindset in the context of obtaining an appropriate understanding of the entity and the environment in which it operates, including its internal control. This understanding, together with more general business acumen and experience, are foundational to the auditor’s identification and assessment of the risks of material misstatement in an entity’s financial statements, the planning and performance of further audit procedures, the assessment of the sufficiency and appropriateness of audit evidence, and the basis for reaching appropriate conclusions.

17. The GAWG agrees that professional skepticism is the foundation to the performance of high quality group audits, and therefore an essential aspect when the group engagement team is performing audit procedures, and evaluating whether sufficient appropriate audit evidence has been obtained. Accordingly, as further consideration is given to revising ISA 600 (and potentially other ISAs) to improve audit quality of group audits, the GAWG believes that further reflection about how to foster a more questioning mindset in the audit process should be undertaken; bearing in mind however, that changes to auditing standards alone are unlikely to be effective in responding to the challenges related to professional skepticism. The GAWG also recognizes that professional skepticism can be interpreted or applied in many different ways, and may be affected by the customs, culture or laws in each jurisdiction.

Consideration of Work of Others

18. Consideration of the activities of other standard setters with relevant active projects (e.g., the Public Company Accounting Oversight Board (PCAOB) in the U.S.)\(^{11}\) will also be monitored for changes that may inform the work of the IAASB. The GAWG will also continue to monitor the activities of national standard setters (NSS) in this area.

19. Further, the GAWG will also seek to advance its understanding of jurisdictional differences (where they exist) with respect to how ISA 600 is adopted nationally or implemented in practice.

Matter for IAASB Consideration

1. The IAASB is asked for its views on the matters noted in paragraphs 1–19 above.

Description of Issues and Development of Working Group Recommendations

20. Overall, the GAWG believes the basic principles underpinning ISA 600 remain sound. However, the GAWG is of the view that consideration should be given to understanding, in more depth, the issues that have been identified and assessing whether and if so, how, the issues that have been identified may be addressed through strengthened or clarified requirements, through enhancements or clarification to the application material or alternatively whether other courses of action might be more effective.

\(^{11}\) For example, the PCAOB currently has a project on the “Supervision of Other Auditors and Multi-location Audit Engagements” underway. Observations from the PCAOB’s oversight activities illustrate the need for improvement in audit procedures performed by the lead auditor with respect to the work performed by other auditors. The PCAOB’s current standard setting agenda indicates that staff is drafting, for its Board’s consideration, a proposal that would address this need by improving the auditing standards that govern planning, supervising, and performance of audits including other auditors and multi-location audit engagements.
21. As a starting point, the GAWG considered the extant ISA requirements and application material relevant to the issues highlighted to identify gaps that may warrant further IAASB consideration. The GAWG focused firstly on the requirements and application guidance within ISA 600, but also included the other relevant ISAs\textsuperscript{12} in its overall analysis.

22. The GAWG notes that the majority of the requirements in the ISAs either provide a framework for decisions to be made in an audit, which involve the application of professional judgment for them to be properly made. In some cases, further guidance in the application material may help explain what a requirement means or is intended to cover, or may include additional examples of procedures that may be appropriate in the circumstances. In reflecting on possible gaps in the ISAs (as described in the tables below), the GAWG believes that there may be opportunities to clarify or supplement the existing requirements and application material and in so doing, enhance audit quality and improve the overall consistency in practice. Clarifying the ISAs in this way may include the elevation of existing application material to requirements, or drafting new or revised requirements and application material.

23. However, there may also be some issues, which due to their underlying nature, are unlikely to be able to be addressed, or fully addressed, by changes to the standards. Such issues include, for example, those driven by:

- Increasing complexity and variability of group structures.
- Differing laws and regulations applying to group entities and the component entities within the group structure, for example matters such as differing ethical requirements for the auditors of group and component entities.
- Matters relating to the ability of the group auditor to obtain access to component management or component auditors, including potentially access to component auditor working papers.
- Differing degrees of centralization and commonality of systems and processes within group entities, including for example, increased and varying use of shared services centers or use of differing systems and processes by entities within group environments.

In relation to these matters, consideration could also be given to whether other IAASB actions, such as additional guidance (e.g., in a non-authoritative Staff publication) may provide further support to auditors when applying the requirements and guidance of the ISAs to different situations. Such other actions may be contemplated instead of or in addition to amending requirements or guidance in the ISAs (i.e., to provide additional implementation support and demonstrate application of the ISAs in particular circumstances).

24. The GAWG’s preliminary views on each of the issues that have been identified are noted in the tables below, including suggestions on how the issues might be addressed. In some cases the GAWG is of the view that further analysis of the factors is needed to further understand an issue before suggesting a view as to the nature of the issue and how it might be addressed, for example, the issue may be one of the auditor’s performance, opposed to one that is contextual (e.g., a “gap” in the ISAs). It is intended that the Board’s views on the matters in the tables below, together with the issues and applicable ISA requirements and application material, will form the basis for the description of the

\textsuperscript{12} ISA 600 contains special considerations in relation to audits of group financial statements, and does not replace the application of all the other applicable ISAs, as noted in paragraph 1 of ISA 600.
matters in the GADP. The table also incorporates the requirements and application material in extant ISA 600 considered by the GAWG as part of its deliberations, as well as relevant information about the development of the relevant requirements and guidance, for informational purposes.

Acceptance / Continuation of the Engagement

25. Acceptance of the Group Audit Engagement

Development of ISA 600\(^\text{13}\) Significant changes were proposed in the initial draft relating to ISA 600 in 2003 (ED 2003) which called for more work to be done by the group engagement team at the acceptance and continuance stage, including requirements to obtain a preliminary understanding of the group engagement team’s ability to participate appropriately in the work of the component auditor, thereby emphasizing the group engagement partner’s responsibility for the group audit.

Initially, ED 2003 suggested that it would be unusual for the group engagement team to accept an engagement to audit group financial statements where the group engagement team did not directly perform work on more than 50% of the group assets, liabilities, cash flows, profit, or turnover, unless the group engagement team was able to participate appropriately in the work of the other auditor. ED 2005 and ED 2006 progressed this by eliminating the required % of work to be performed by the group engagement team, focusing instead on the consideration by the group engagement team of being able to obtain sufficient appropriate audit evidence on which to base the group audit opinion, by the group engagement team performing work on significant components, or being involved in the work of other auditors performing work on significant components.

Issues Identified

- Inadequate consideration of matters relevant to the acceptance and continuance of group audit engagements,\(^\text{14}\) for example, the ability to have necessary access to financial information at the component level. (Audit Oversight Bodies)\(^\text{15}\)
- Insufficient specificity about how to determine when the group engagement team is entitled to act as auditor of the group financial statements (e.g. if a significant portion of the consolidated information is audited by component auditors and, in addition to other factors,\(^\text{16}\) the component auditors are from another firm that does not have common policies and procedures with those of the group engagement team in performing the work including: common policies and procedures for performing the work (audit methodologies); common quality control policies and procedures; and common monitoring

\(^{13}\) Hereon after, the three exposure drafts are referred to as: ED 2003 (exposure draft issued in 2003); ED 2005 (exposure draft issued in 2005) and ED 2006 (exposure draft issued in 2006)

\(^{14}\) This may also be linked to access issues below.

\(^{15}\) All references hereafter that refer to views expressed by audit oversight bodies do not infer that (a) all audit inspection bodies have these views; and (b) the issues arise in all audits inspected; rather the issues noted would appear to be relatively common findings from a number of inspectors from some audit files inspected as part of their periodic inspections.

\(^{16}\) See ISA 600 paragraph A33
policies and procedures (hereafter referred to as common policies and procedures). *(ISA Implementation Monitoring)*\(^{17}\)

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<thead>
<tr>
<th>Relevant ISA References</th>
<th>ISA 600</th>
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<tr>
<td><strong>Requirements</strong></td>
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<td><strong>Acceptance and Continuance</strong></td>
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<td>12. In applying ISA 220, the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. <em>(Ref: Para. A10–A12)</em></td>
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<td>13. If the group engagement partner concludes that:</td>
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<td>(a) it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and</td>
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<td>(b) the possible effect of this inability will result in a disclaimer of opinion on the group financial statements,(^{18})</td>
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<td>the group engagement partner shall either:</td>
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<td>(a) in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement, where withdrawal is possible under applicable law or regulation; or</td>
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<td>(b) where law or regulation prohibits an auditor from declining an engagement or where withdrawal from an engagement is not otherwise possible, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. <em>(Ref: Para. A13–A19)</em></td>
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\(^{17}\) The *findings* from the ISA Implementation Monitoring project summarize the views from a broad range of stakeholders, including regulators and audit inspection bodies, national standard setters, firms, public sector auditors, IFAC member bodies and individuals. Throughout this document, the GAWG has made some additions or provided additional clarification to the ISA Implementation Monitoring findings based on additional input or further discussion.

\(^{18}\) ISA 705, *Modifications to the Opinion in the Independent Auditor’s Report*
Application Material

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Expectation to Obtain Sufficient Appropriate Audit Evidence (Ref: Para. 13)

A13. A group may consist only of components not considered significant components. In these circumstances, the group engagement partner can reasonably expect to obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team will be able to:

(a) Perform the work on the financial information of some of these components; and

(b) Be involved in the work performed by component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.

Preliminary Views of the GAWG

With regard to inadequate consideration of matters relevant to the acceptance and continuance of group audit engagements raised by audit oversight bodies as an issue, the GAWG believes more information is needed to clearly identify which areas are not specifically being complied with. In doing so, the GAWG will also explore whether this is a performance issue of the auditor, a gap in the standard, or a combination of these.

In relation to the specificity of the requirements and guidance addressing when the group auditor is entitled to act as auditor of the group financial statements, the GAWG is of the preliminary view that the issue has been raised in reference to specific situations, for example in situations where the engagement partner is not located where the majority of the audit work is performed, i.e., audits of financial statements of entities where the majority of the general and financial management of the entity and the majority of the business activity and related processing of transactions is undertaken in jurisdictions other than where the entity is registered or where the entity maintains a correspondence address or listing19 or where the group auditor may not have sufficient access to component management or the component auditors, and therefore would be unable to be sufficiently involved to the extent necessary to obtain sufficient appropriate audit evidence (note: access issues are discussed separately below). The GAWG suggests that additional guidance about relevant considerations for the auditor to address when accepting or continuing a group engagement in different circumstances, would be helpful. The GAWG does not propose revisiting previous Board decisions about using explicit benchmarks in evaluating the group auditor’s ability to accept or continue a group engagement. Instead, because of the wide diversity of situations that exist in practice, the GAWG believes that further guidance for auditors, either in the application material or in a Staff publication, may be helpful.

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19 This would also include consideration of those situations where the audit is not a group audit but where multiple auditors are involved, and which may also impact other ISAs, including ISA 220 and ISA 230.
In addition, strengthening the requirements for the necessary documentation by the auditor to evidence the judgments made when accepting or continuing an engagement may also be beneficial. The GADP will then seek to obtain additional perspectives about the issues that have been identified, including stakeholder views about the most appropriate actions to address them.

### Further Information Needed

Audit oversight bodies:
To the extent available, any additional information about the nature of the issues being raised in relation to acceptance or continuation of group audit engagements.

### Development of ISA 600

All three exposure drafts in revising ISA 600 (i.e., ED 2003, ED 2005 and ED 2006) reflected the IAASB’s view that a restriction on the group engagement team’s access to relevant information is a scope limitation, which would affect the group audit opinion (and may result in a qualified or disclaimer of opinion). The requirements note that the group engagement partner should, in the case of a new engagement, not accept an engagement where a scope limitation would result in a disclaimer, or should resign from the engagement if it is concluded that it will not be possible to obtain sufficient appropriate audit evidence. In addition, it was agreed that a requirement not to accept the engagement would be limited to cases where restrictions were imposed by group management.20

### Issues identified

- Insufficient guidance about what to do when the group engagement team does not have access to the information necessary to be able to obtain sufficient appropriate audit evidence to support the audit opinion (particularly in cases where the management of the group entity does not have the ability to direct management of the component to cooperate with the group engagement team or the group engagement team’s ability to interact with the component auditor is restricted, such as the case may be with non-controlled entities21 (e.g., investments accounted for in accordance with the equity method); or where the laws and regulations of a jurisdiction prohibit the necessary access). *(ISA Implementation Monitoring)*

- Insufficient focus by auditors on access issues such as when the component is in a foreign jurisdiction in which access issues typically arise or the component is an equity method investee (including documentation of judgments made and rationale for approach taken). *(Audit Oversight Bodies)*

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20 ISA 600, paragraphs 13 and A16–A18

21 Non-controlled entities could also meet the definition of a component—an entity or business activity for which group or component management prepares financial information that should be included in the group financial statements (ISA 600, paragraph 9(a)).
Relevant ISA References

**ISA 600: Requirements**

...  

13. If the group engagement partner concludes that:

(a) it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and 

(b) the possible effect of this inability will result in a disclaimer of opinion on the group financial statements,

the group engagement partner shall either:

(a) in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement, where withdrawal is possible under applicable law or regulation; or 

(b) where law or regulation prohibits an auditor from declining an engagement or where withdrawal from an engagement is not otherwise possible, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: Para. A13–A19)

**Application Material**

...  

*Access to Information* (Ref: Para. 13)

A14. The group engagement team’s access to information may be restricted by circumstances that cannot be overcome by group management, for example, laws relating to confidentiality and data privacy, or denial by the component auditor of access to relevant audit documentation sought by the group engagement team. It may also be restricted by group management.

A15. Where access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a component that is accounted for by the equity method of accounting. If the component is not a significant component, and the group engagement team has a complete set of financial statements of the component, including the auditor’s report thereon, and has access to information kept by group management in relation to that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence in relation to that component. If the component is a significant component, however, the group engagement team will not be able to comply with the requirements of this ISA relevant in the circumstances of the group audit. For example, the group engagement team will not be able to comply with the
requirement in paragraphs 30–31 to be involved in the work of the component auditor. The group engagement team will not, therefore, be able to obtain sufficient appropriate audit evidence in relation to that component. The effect of the group engagement team’s inability to obtain sufficient appropriate audit evidence is considered in terms of ISA 705.

A16. The group engagement team will not be able to obtain sufficient appropriate audit evidence if group management restricts the access of the group engagement team or a component auditor to the information of a significant component.

A17. Although the group engagement team may be able to obtain sufficient appropriate audit evidence if such restriction relates to a component considered not a significant component, the reason for the restriction may affect the group audit opinion. For example, it may affect the reliability of group management’s responses to the group engagement team’s inquiries and group management’s representations to the group engagement team.

A18. Law or regulation may prohibit the group engagement partner from declining or withdrawing from an engagement. For example, in some jurisdictions the auditor is appointed for a specified period of time and is prohibited from withdrawing before the end of that period. Also, in the public sector, the option of declining or withdrawing from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, this ISA still applies to the group audit, and the effect of the group engagement team’s inability to obtain sufficient appropriate audit evidence is considered in terms of ISA 705.

A19. Appendix 1 contains an example of an auditor’s report containing a qualified opinion based on the group engagement team’s inability to obtain sufficient appropriate audit evidence in relation to a significant component accounted for by the equity method of accounting, but where, in the group engagement team’s judgment, the effect is material but not pervasive.

| Preliminary Views of the GAWG<sup>22</sup> | Situations where there is restricted access have been contemplated in paragraphs A14-A19 of ISA 600 as guidance for the requirement in paragraph 13 relating to the acceptance and continuance of the audit engagement where the group engagement partner concludes that restricted access will impact the ability to obtain sufficient appropriate audit evidence to support the audit opinion. This application material covers both situations where the restrictions are imposed because of circumstance and where the component auditor refuses to provide access to relevant audit documentation sought by the group engagement team.

In light of the existing requirements and guidance, the GAWG suggests that more information about the access issues is solicited from both the audit oversight bodies, firms (through firm Board members and GPPC representatives) and others (e.g., NSS) to help understand where the application guidance is inadequate, in order to assist the GAWG formulate a more directed suggested approach to addressing the access issues that have been identified. In particular, the GAWG suggests obtaining |

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<sup>22</sup> See also discussion about the definition of a component in paragraph 28 below.
further information about the pervasiveness of access issues related to investments accounted for in accordance with the equity method of accounting (and similarly where components are not controlled by the group), to understand if these are the same issues that were raised on initial implementation of the revised standard.\textsuperscript{23} Further information gathering will also help inform the GAWG as to the current nature and pervasiveness of the access issues related to non-controlled group entities, including whether the issues are more prevalent in particular jurisdictions, whether different jurisdictions face different issues or whether the issues are broadly similar and relatively pervasive across jurisdictions. The GAWG remains mindful that certain access issues will likely not be able to be addressed by changes to the standards, but the GAWG will seek to further understand the situations where access issues occur, and how firms are currently dealing with them.

In addition, to focus auditors on the requirements relating to acceptance or continuance of the group engagement where access issues are anticipated or experienced, the GAWG proposes that stakeholder views be solicited in the GADP about clarifying and elevating the application material in paragraph A16 to the requirements to clarify the situation where the group engagement team will not have sufficient access due to restrictions imposed by group management, component management or the component auditor, and therefore that the engagement should not be accepted or continued, and whether a similar requirement may be needed for access issues related to the entity’s circumstances.

The GAWG also notes that there is no explicit requirement in the standard as to what relevant audit documentation is needed to support the group engagement partner’s judgment\textsuperscript{24} about acceptance or continuance of a group audit engagement where access issues are being encountered and proposes that further consideration be given to whether requirements or application guidance addressing the documentation for the requirements for acceptance and continuance need to made more specific or robust.

<table>
<thead>
<tr>
<th>Further Information Gathering Needed</th>
<th>From firms and others (e.g., NSS):</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>To further understand both the nature and the pervasiveness of access issues.</td>
</tr>
<tr>
<td></td>
<td>To understand the pervasiveness of issues around the access to component management and component auditors of non-controlled investments.</td>
</tr>
<tr>
<td></td>
<td>To further explore how access issues are currently being dealt with.</td>
</tr>
<tr>
<td>From audit oversight bodies:</td>
<td>Any additional information that can be provided to better understand the expectations of audit oversight bodies as to the extent of access to component auditors that, in their view, is required, in order to address the requirements and guidance in ISA 600.</td>
</tr>
</tbody>
</table>

\textsuperscript{23} See the report on Phase I from the ISA Implementation Monitoring project.

\textsuperscript{24} Paragraph 8(c) of ISA 230 requires that “significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching hose conclusions” be documented.
Matters for IAASB Consideration

2. The IAASB is asked to consider the GAWG views presented in paragraphs 25–26, and provide its views on the matters noted.

3. The IAASB is asked whether there are any other matters relating to the acceptance or continuation of the engagement as it relates to group audits that the GAWG should further consider.

Planning the Group Audit

27. Group Engagement Team’s Understanding of the Component Auditor

| Development of ISA 600 | The requirements and guidance in relation to the group engagement team’s understanding of the component auditor were strengthened with each ED. In finalizing the standard, and to address concerns about the extent of evidence and documentation necessary to demonstrate compliance with the requirement, the IAASB restructured and amended 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:
|                     | • The degree to which the group engagement team and the component auditor:
|                     | o Use common audit methodologies;
|                     | o Are subject to common policies and procedures;
|                     | o Are subject to a common legal system, language, education, external quality assurance, culture, etc.25
| Issues Identified   | Issues around this area, and using the terms ‘related auditors’ and ‘other auditors’ were heavily debated with various iterations proposed until the appropriate language around factors such as ‘common policies and procedures’ was agreed upon. Guidance was also developed for obtaining the necessary understanding of component auditors in the first year and updating the understanding in subsequent years.26

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25 ISA 600, paragraphs A33–A34
26 ISA 600, paragraph A35
- Insufficient assessment of competence of component auditors by the group engagement team, including:
  - Failure to adequately evaluate whether component auditors have the required skills and expertise for performing the necessary work at the component.
  - For component auditors within the same firm or network, failure to (or inability to) adequately understand and evaluate quality control monitoring results, and for component auditors outside the same firm or network, the results, failure or inability to consider the results of any external quality reviews.
  - Failure to adequately understand the laws and regulations around the necessary licensing requirements applicable to the component auditor, if any, and how this may affect the component auditor’s competence.

(Audit Oversight Bodies)

<table>
<thead>
<tr>
<th>Relevant ISA References</th>
<th>ISA 600 Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Understanding the Component Auditor</td>
<td></td>
</tr>
<tr>
<td>19. If 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: (Ref: Para. A32–A35)</td>
<td></td>
</tr>
<tr>
<td>(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. (Ref: Para. A37)</td>
<td></td>
</tr>
<tr>
<td>(b) The component auditor’s professional competence. (Ref: Para. A38)</td>
<td></td>
</tr>
<tr>
<td>(c) Whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence.</td>
<td></td>
</tr>
<tr>
<td>(d) Whether the component auditor operates in a regulatory environment that actively oversees auditors. (Ref: Para. A36)</td>
<td></td>
</tr>
</tbody>
</table>

Application Material

... 

Group Engagement Team’s Procedures to Obtain an Understanding of the Component Auditor and Sources of Audit Evidence (Ref: Para. 19)

A33. 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 are subject to common policies and procedures, for example:
• Whether the group engagement team and a component auditor share:
  ○ Common policies and procedures for performing the work (for example, audit methodologies);
  ○ Common quality control policies and procedures; or
  ○ Common monitoring policies and procedures.
• The consistency or similarity of:
  ○ Laws and regulations or legal system;
  ○ Professional oversight, discipline, and external quality assurance;
  ○ Education and training;
  ○ Professional organizations and standards; or
  ○ Language and culture.

A34. These factors interact and are not mutually exclusive. For example, the extent of the group engagement team’s procedures to obtain an understanding of Component Auditor A, who consistently applies common quality control and monitoring policies and procedures and a common audit methodology or operates in the same jurisdiction as the group engagement partner, may be less than the extent of the group engagement team’s procedures to obtain an understanding of Component Auditor B, who is not consistently applying common quality control and monitoring policies and procedures and a common audit methodology or operates in a foreign jurisdiction. The nature of the procedures performed in relation to Component Auditors A and B may also be different.

A35. 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 framework that operates under and complies with common monitoring policies and procedures;
• Visit the component auditor to discuss the matters in paragraph 19(a)–(c);
• Request the component auditor to confirm the matters referred to in paragraph 19(a)–(c) in writing. Appendix 4 contains an example of written confirmations by a component auditor;
• Request the component auditor to complete questionnaires about the matters in paragraph 19(a)–(c);
• Discuss the component auditor with colleagues in the group engagement partner’s firm, or with a reputable third party that has knowledge of the component auditor; or
• Obtain confirmations from the professional body or bodies to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.
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 in relation to the matters listed in paragraph 19(a)–(c) has changed since the previous year.

A36. Where independent oversight bodies have been established to oversee the auditing profession and monitor the quality of audits, awareness of the regulatory environment may assist the group engagement team in evaluating the independence and competence of the component auditor. Information about the regulatory environment may be obtained from the component auditor or information provided by the independent oversight bodies.

Ethical Requirements that Are Relevant to the Group Audit (Ref: Para. 19(a))

A37. When performing work on the financial information of a component for a group audit, the component auditor is subject to ethical requirements that are relevant to the group audit. Such requirements may be different or in addition to those applying to the component auditor when performing a statutory audit in the component auditor’s jurisdiction. The group engagement team therefore obtains an understanding whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit, sufficient to fulfill the component auditor’s responsibilities in the group audit.

The Component Auditor’s Professional Competence (Ref: Para. 19(b))

A38. The group engagement team’s understanding of the component auditor’s professional competence may include whether the component auditor:

- Possesses an understanding of auditing and other standards applicable to the group audit that is sufficient to fulfill the component auditor’s responsibilities in the group audit;
- Possesses the special skills (for example, industry specific knowledge) necessary to perform the work on the financial information of the particular component; and
- Where relevant, possesses an understanding of the applicable financial reporting framework that is sufficient to fulfill the component auditor’s responsibilities in the group audit (instructions issued by group management to components often describe the characteristics of the applicable financial reporting framework).

Preliminary Views of the GAWG

The GAWG is of the preliminary view that the requirements about the understanding of the competence and independence of the component auditor are clear. However, in recognition of the issues that have been identified, the GAWG believes that greater clarity in the application material in ISA 600 in relation to how to assess the competence and independence of the component auditor may be beneficial. In

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27 ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, includes a new requirement for auditors to identify the jurisdiction of origin of the relevant ethical requirements to increase transparency relating to the particular audit engagement.
particular such guidance might more clearly address the situation when the group engagement team does not have previous experience with the component auditor by addressing the consideration of the common policies and procedures applying to the group engagement team and to component auditors, and the impact of other relevant factors in this context when judging the nature and extent to which the group engagement team can use the work of the component auditor.

Specifically, adding examples, to paragraph A38, such as: understanding and evaluating quality control monitoring results or the results of external quality reviews for component auditors; or consideration of the effect on the assessment of the competence of the component auditor if there are different or no national or jurisdictional licensing requirements, could be explored. Stakeholder views thereon could be obtained through the GADP.

In addition, the GAWG believes that additional input from audit oversight bodies may be useful to better inform the understanding of the issues, including views as to the possible role of clearer or stronger documentation requirements or guidance in improving audit quality in this area.

<table>
<thead>
<tr>
<th>Further Information Gathering Needed</th>
<th>From firms:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Further understanding of the independence issues relating to group audits, in particular the practical challenges that auditors are facing in situations where the independence requirements at the group level differ from those applicable in jurisdictions where component auditors are performing work.</td>
</tr>
<tr>
<td>From audit oversight bodies:</td>
<td>To the extent available, any additional information to inform a better understanding of the underlying inspection concerns, including views as to whether enhanced documentation requirements or guidance might be a factor in improving auditor performance.</td>
</tr>
</tbody>
</table>

28. **Identifying Components, including Significant Components (Definition)**

<table>
<thead>
<tr>
<th>Development of ISA 600</th>
<th>The definition of a component was strongly debated during the project to develop ISA 600, and various changes made as the ED’s progressed. The IAASB revised the definition and added application material explaining that the structure of a group affects how components are identified, and includes consideration of both the legal and organizational structure (i.e., how the group financial reporting system is structured). Application material was added in paragraph A5 of ISA 600 providing an example of a quantitative benchmark (currently 15% of a chosen benchmark) for the identification of a significant component.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issues Identified</td>
<td>• Different interpretations about what comprises a component based on the application of the definition. (<em>ISA Implementation Monitoring</em>)</td>
</tr>
<tr>
<td></td>
<td>• Issues with not properly identifying significant components. (<em>Audit Oversight Bodies</em>)</td>
</tr>
</tbody>
</table>

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28 ISA 600, paragraphs A11–A12
### Relevant ISA References

### Definitions

9. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) **Component** – An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements. (Ref: Para. A2–A4)

   

   (m) **Significant component** – A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements. (Ref: Para. A5–A6)

#### Application Material

### Definitions

**Component** (Ref: Para. 9(a))

A2. The structure of a group affects how components are identified. For example, the group financial reporting system may be based on an organizational structure that provides for financial information to be prepared by a parent and one or more subsidiaries, joint ventures, or investees accounted for by the equity or cost methods of accounting; by a head office and one or more divisions or branches; or by a combination of both. Some groups, however, may organize their financial reporting system by function, process, product or service (or by groups of products or services), or geographic locations. In these cases, the entity or business activity for which group or component management prepares financial information that is included in the group financial statements may be a function, process, product or service (or group of products or services), or geographic location.

A3. Various levels of components may exist within the group financial reporting system, in which case it may be more appropriate to identify components at certain levels of aggregation rather than individually.

A4. Components aggregated at a certain level may constitute a component for purposes of the group audit; however, such a component may also prepare group financial statements that incorporate the financial information of the components it encompasses (that is, a subgroup). This ISA may therefore be applied by different group engagement partners and teams for different subgroups within a larger group.

**Significant Component** (Ref: Para. 9(m))

A5. As the individual financial significance of a component increases, the risks of material misstatement of the group financial statements ordinarily increase. The group engagement team may apply a percentage to a chosen benchmark as an aid to identify components that are of individual financial significance. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgment. Depending on the nature and
circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, profit or turnover. For example, the group engagement team may consider that components exceeding 15% of the chosen benchmark are significant components. A higher or lower percentage may, however, be deemed appropriate in the circumstances.

A6. The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances (that is, risks that require special audit consideration). For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

<table>
<thead>
<tr>
<th>Preliminary Views of the GAWG</th>
</tr>
</thead>
<tbody>
<tr>
<td>There are no specific requirements related to the determination of components and significant components in ISA 600, rather the determination is implicit in applying the definitions to the requirements in the standard about the nature of the work required to be designed and performed around the components. Therefore not properly identifying the components, in particular the significant components, impacts the evidence obtained and the sufficiency and appropriateness of that evidence to support the group audit opinion.</td>
</tr>
<tr>
<td>The GAWG is of the preliminary view that the issues that have been identified are likely auditor performance issues as the application material provided to support the definition of a component and significant component appears sufficiently detailed to provide a basis for applying the principles in various circumstances. (Also see linked discussion about identifying significant risks at the group and component level below).</td>
</tr>
<tr>
<td>However, in its deliberations, the GAWG has identified related issues that in its view should be considered further:</td>
</tr>
<tr>
<td>• The need to revisit some of the application guidance in light of current accounting standards. For example, in paragraph A2, as it relates to investments accounted for at cost and whether they should be considered components.</td>
</tr>
<tr>
<td>• Whether clarification is needed about the meaning of “consolidation process” in paragraph 10 and how its meaning affects the identification of components, as defined, as opposed to other situations that might be covered by paragraph 2 of ISA 600. The GAWG also notes that complexity arises when “sub-consolidations” are involved.</td>
</tr>
<tr>
<td>The GAWG proposes that the GADP seek views on the adequacy of the definitions, and their related application material.</td>
</tr>
</tbody>
</table>

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29 ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs 27–29

30 ISA 600 paragraph 50(a) requires the group engagement team to document an analysis of components, indicating those that are significant.
Further Information Gathering Needed

<table>
<thead>
<tr>
<th>From firms:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Further understanding of the difficulties experienced in the interpretation and practical application of the definitions specific to Group Audits.</td>
</tr>
</tbody>
</table>

### 29. Component Materiality

#### Development of ISA 600

In finalizing the standard, different views were expressed by IAASB members about the different levels of materiality that were being proposed, in particular in relation to the need for the amount(s) lower than component materiality as this may lead to excessive work, especially where the audit was being performed only for the purpose of the group audit. Accordingly the concept of requiring the group auditor to establish an amount lower than component materiality was deleted from the proposals, but the application material was expanded to emphasize that the component auditor should comply with the requirements and guidance in ISA 320 when seeking to address aggregation risk at a component level for an audit of the financial information of a component.

#### Issues identified

- Significant variation in practice in relation to the determination of component materiality. *(ISA Implementation Monitoring)*
- Materiality to be used by component auditors when performing work at selected components not appropriately determined, therefore aggregation risk not properly addressed. *(Audit Oversight Bodies)*

#### Relevant ISA References

**ISA 600**

**Definitions**

For purposes of the ISAs, the following terms have the meanings attributed below:

...  
(d) Component materiality – The materiality for a component determined by the group engagement team.

**Requirements**

...  
Materiality

21. The group engagement team shall determine the following: (Ref: Para. A42)

   (a) Materiality for the group financial statements as a whole when establishing the overall group audit strategy.

   (b) If, in the specific circumstances of the group, there are particular classes of transactions, account balances or disclosures in the group financial statements for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be
expected to influence the economic decisions of users taken on the basis of the group financial statements, the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

(c) Component materiality for those components where component auditors will perform an audit or a review for purposes of the group audit. To reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole, component materiality shall be lower than materiality for the group financial statements as a whole. (Ref: Para. A43–A44)

(d) The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: Para. A45)

**Application Material**

...  

Materiality (Ref: Para. 21–23)

A42. The auditor is required: 33

(a) When establishing the overall audit strategy, to determine:

(i) Materiality for the financial statements as a whole; and

(ii) If, in the specific circumstances of the entity, there are particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures; and

(b) To determine performance materiality.

In the context of a group audit, materiality is established for both the group financial statements as a whole, and for the financial information of the components. Materiality for the group financial statements as a whole is used when establishing the overall group audit strategy.

A43. To reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole, component materiality is set lower than materiality for the group financial statements as a whole. Different component materiality may be established for different components. Component materiality need not be an arithmetical portion of the materiality for the group financial statements as a whole and, consequently, the aggregate of component materiality for the different components may exceed the

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33 ISA 320, paragraphs 10–11
materiality for the group financial statements as a whole. Component materiality is used when establishing the overall audit strategy for a component.

A44. Component materiality is determined for those components whose financial information will be audited or reviewed as part of the group audit in accordance with paragraphs 26, 27(a) and 29. Component materiality is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate.

A45. A threshold for misstatements is determined in addition to component materiality. Misstatements identified in the financial information of the component that are above the threshold for misstatements are communicated to the group engagement team.

A46. In the case of an audit of the financial information of a component, the component auditor (or group engagement team) determines performance materiality at the component level. This is necessary to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial information of the component exceeds component materiality. In practice, the group engagement team may set component materiality at this lower level. Where this is the case, the component auditor uses component materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks as well as for evaluating whether detected misstatements are material individually or in the aggregate.

Preliminary Views of the GAWG

Many of the issues related to component materiality are intrinsically linked to the requirements and guidance in ISA 320. In its Disclosures project, the IAASB has acknowledged that work currently being undertaken by the International Accounting Standards Board (IASB) may give rise to further implications to the ISAs relating to materiality. The IAASB will continue to monitor the IASB’s developments, and in conjunction with its planned consultation on the Work Plan 2017–2018, determine the need for a more holistic review of ISA 320. Therefore any work done in terms of this group audits project should not pre-judge the outcomes of those efforts.

However, the GAWG is of the view that further consideration on the certain aspects that are specifically relevant to the determination and application of component materiality in the context of group audits is appropriate, including in relation to the concept of aggregation risk and how to consider and address it. The GAWG is also open to the possibility of developing more topic-specific guidance in this area, however without infringing on the basic principles in ISA 320 until a more holistic review of that standard has been undertaken. For example, the GADP could explore stakeholder perspectives on areas where some guidance may be helpful, such as:

- How different components might warrant different levels of component materiality (and component performance materiality);
- Guidance about the concept of aggregation risk and the group auditor’s consideration of how aggregation risk is addressed in the context of the

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34 As ISA 320 is revised, changes to ISA 450, Evaluation of Misstatements Identified during the Audit, will also likely be required.
established levels of component materiality and performance materiality for the work done relating to significant components within the group, as well as non-significant components that may be significant in the aggregate; and

- Determining and applying component materiality to work performed on investments accounted for in accordance with the equity method of accounting.

In its deliberations, the GAWG has also identified the need to better understand how materiality is applied in situations where specified audit procedures are performed (i.e., relating to the likely risks of material misstatement in terms of paragraph 27(c) of ISA 600). Views from stakeholders on this matter will be sought in the GADP.

### 30. The Group Engagement Team’s Understanding of the Component

<table>
<thead>
<tr>
<th>Development of ISA 600</th>
<th>Understanding of a group’s components, as part of obtaining an understanding of the entity and its environment as required by ISA 315 (Revised), was debated with other parts of the standard in the revision and development of ISA 600, but not specifically as a topic in its own right.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issues Identified</td>
<td>More clarity in the standards needed about the understanding needed as it relates to a group’s components, as part of obtaining an understanding of the entity and its environment, e.g., business practices, legal structures, laws and regulations, customs (ISA Implementation Monitoring)</td>
</tr>
<tr>
<td></td>
<td>Auditors not obtaining a sufficient understanding of the components to effectively “drive” the group audit (Audit Oversight Bodies)</td>
</tr>
</tbody>
</table>
| Relevant ISA References | **ISA 600:** Requirements

... Understanding the Group, Its Components, and Their Environments

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment. The group engagement team shall:

(a) Enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage; and

(b) Obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: Para. A23–A29)

18. The group engagement team shall obtain an understanding that is sufficient to:

(a) Confirm or revise its initial identification of components that are likely to be significant; and
(b) Assess the risks of material misstatement of the group financial statements, whether due to fraud or error.\(^{35}\) (Ref: Para. A30–A31)

**Application Material**

...  

**Understanding the Group, Its Components, and Their Environments**

*Matters about Which the Group Engagement Team Obtains an Understanding* (Ref: Para. 17)

A23. ISA 315 (Revised) contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity’s financial performance.\(^{36}\) Appendix 2 of this ISA contains guidance on matters specific to a group, including the consolidation process.

...  

**Discussion among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud** (Ref: Para. 17)

A28. The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasizing the risks due to fraud. In a group audit, these discussions may also include the component auditors.\(^{37}\) The group engagement partner’s determination of who to include in the discussions, how and when they occur, and their extent, is affected by factors such as prior experience with the group.

A29. The discussions provide an opportunity to:

- Share knowledge of the components and their environments, including group-wide controls.

...  

**Risk Assessment** (Ref: Para. 18)

A31. The group engagement team’s assessment at group level of the risks of material misstatement of the group financial statements is based on information such as the following:

- Information obtained from the understanding of the group, its components, and their environments, and of the consolidation process, including audit evidence obtained in evaluating the design and implementation of group-wide controls and controls that are relevant to the consolidation.

\(^{35}\) ISA 315 (Revised)  

\(^{36}\) ISA 315 (Revised), paragraphs A24–A48  

\(^{37}\) ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 15; ISA 315 (Revised), paragraph 10
• Information obtained from the component auditors.

[In addition, there are further matters for consideration about the auditor’s understanding of the component on acceptance of an engagements as follows:]

Obtaining an Understanding at the Acceptance or Continuance Stage (Ref: Para. 12)

A10. In the case of a new engagement, the group engagement team’s understanding of the group, its components, and their environments may be obtained from:

• Information provided by group management;
• Communication with group management; and
• Where applicable, communication with the previous group engagement team, component management, or component auditors.

A11. The group engagement team’s understanding may include matters such as the following:

• The group structure, including both the legal and organizational structure (that is, how the group financial reporting system is organized).
• Components’ business activities that are significant to the group, including the industry and regulatory, economic and political environments in which those activities take place.
• The use of service organizations, including shared service centers.
• A description of group-wide controls.
• The complexity of the consolidation process.
• Whether component auditors that are not from the group engagement partner’s firm or network will perform work on the financial information of any of the components, and group management’s rationale for appointing more than one auditor.
• Whether the group engagement team:
  (a) Will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management, component information, and the component auditors (including relevant audit documentation sought by the group engagement team); and
  (b) Will be able to perform necessary work on the financial information of the components.

A12. In the case of a continuing engagement, the group engagement team’s ability to obtain sufficient appropriate audit evidence may be affected by significant changes, for example:

• Changes in the group structure (for example, acquisitions, disposals, reorganizations, or changes in how the group financial reporting system is organized).
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<table>
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<td></td>
<td>Changes in components’ business activities that are significant to the group.</td>
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<tr>
<td></td>
<td>Changes in the composition of those charged with governance of the group, group management, or key management of significant components.</td>
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<td></td>
<td>Concerns the group engagement team has with regard to the integrity and competence of group or component management.</td>
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<tr>
<td></td>
<td>Changes in group-wide controls.</td>
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<td>Changes in the applicable financial reporting framework.</td>
</tr>
</tbody>
</table>

**ISA 315 (Revised)**

**Requirements**

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**The Entity and Its Environment**

11(a) The auditor shall obtain an understanding of the following:

(a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework. (Ref: Para. A24–A29)

(b) The nature of the entity, including:

(i) its operations;

(ii) its ownership and governance structures;

(iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and

(iv) the way that the entity is structured and how it is financed, to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. (Ref: Para. A30–A34)

**Application Material**

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**Regulatory Factors**

A26. Relevant regulatory factors include the regulatory environment. The regulatory environment encompasses, among other matters, the applicable financial reporting framework and the legal and political environment. Examples of matters the auditor may consider include:

- Accounting principles and industry-specific practices.
- Regulatory framework for a regulated industry.
- Legislation and regulation that significantly affect the entity’s operations, including direct supervisory activities.
- Taxation (corporate and other).
- Government policies currently affecting the conduct of the entity’s business, such as monetary, including foreign exchange controls, fiscal,
financial incentives (for example, government aid programs), and tariffs or trade restrictions policies.

- Environmental requirements affecting the industry and the entity’s business.

ISA 250 includes some specific requirements related to the legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates.38

### Preliminary Views of the GAWG

Although certain aspects (as identified in the issues noted above) of the required understanding of the entity and its environment are not specifically covered in ISA 600 (for example, relevant industry, regulatory, and other external factors including the applicable financial reporting framework), the requirement in paragraph 17(a) as well as the overarching requirement in paragraphs 11(a) and A26 of ISA 315 (Revised) would adequately, in the view of the GAWG, require auditors to obtain the necessary understanding of the entity and its environment in order to perform their risk assessments.

The issues relating to the group auditor’s understanding of the component as noted in the issues identified above are therefore not, in the view of the GAWG, seen as something specifically due to the requirements being inadequate or lacking. However, the GAWG is of the view that more specificity through relevant examples of areas to consider when obtaining an understanding of the entity may be helpful to the group engagement team to explain more precisely what the required understanding entails. There could for example, be a more direct link to the relevant paragraphs in ISA 315 (Revised) to reinforce that the understanding of the components in a group audit builds upon the requirements of ISA 315 (Revised). Stakeholder views on these matters will be sought in the GADP.

In deliberating the issues related to the group engagement team’s understanding of the component within a group, the GAWG also identified a few related areas where further understanding would be helpful:

- How the group engagement team may be able to use the work of component auditors with differing levels of involvement, for example, when the component auditor is from a firm that does not have the same policies and procedures or is in a different jurisdiction, the nature and extent of the group engagement team’s understanding of the component may need to be greater and the work of the component auditor may be used to a different extent than when the component auditor is from the same firm as the group auditor and in the same jurisdiction.
- The issues that are encountered by group auditors in practice when gaining an understanding of the components.
- How firms are dealing with issues where components within the entity have non-coterminous year ends.

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38 ISA 250, Consideration of Laws and Regulations in an Audit of Financial Statements, paragraph 12
The GAWG believes it would be useful to further explore whether guidance relating to these issues could or should be developed, either for inclusion as application material or in a Staff publication.

<table>
<thead>
<tr>
<th>Further Information Gathering Needed</th>
<th>From firms</th>
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<tbody>
<tr>
<td>Further exploring the impact on the group engagement team's understanding of the component when, for example, what the implications might be when the component auditor is from a firm that has common policies and procedures or is from the same jurisdiction and when the component auditor does not have common policies and procedures or is from a different jurisdiction; and understanding how firms deal with components with non-coterminous year ends.</td>
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<tr>
<td>From audit oversight bodies:</td>
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<tr>
<td>To the extent available, any additional information to assist in the understanding of their views on different levels of involvement in the work on the component auditor.</td>
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### 31. Identifying Significant Risks in the Context of a Group Audit

<table>
<thead>
<tr>
<th>Development of ISA 600</th>
<th>Identifying significant risks in the context of a group audit was not an area heavily debated by the Board.</th>
</tr>
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<tbody>
<tr>
<td>Issues Identified</td>
<td>- More guidance needed on meaning of 'significant risks' in a group context. (ISA Implementation Monitoring)</td>
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<tr>
<td></td>
<td>- Issues identified with assessing the risks of the group engagement, including risks that are specific to individual components that may be a risk for the overall group or other components in the group. (Audit Oversight Bodies)</td>
</tr>
<tr>
<td>Relevant ISA References</td>
<td>ISA 600 does not contain specific guidance on assessing significant risks in a group context, although the group engagement team is expected to consider significant risks relevant to the group financial statements in determining significant components.³⁹</td>
</tr>
</tbody>
</table>

#### ISA 315 (Revised)

**Definitions**

1. For purposes of the ISAs, the following terms have the meanings attributed below:

   ...  

   (e) Significant risk – An identified and assessed risk of material misstatement that, in the auditor’s judgment, requires special audit consideration.

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³⁹ Although no specific reference to identifying significant risks, work related to significant risks can be found in ISA 600, paragraph 27(c), which requires the auditor to perform specified audit procedures for significant risks.
Requirements

Risks that Require Special Audit Consideration

28. As part of the risk assessment as described in paragraph 25, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

29. In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:
   (a) Whether the risk is a risk of fraud;
   (b) Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention;
   (c) The complexity of transactions;
   (d) Whether the risk involves significant transactions with related parties;
   (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
   (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual. (Ref: Para. A132–A136)

Application Material

Significant Risks

Identifying Significant Risks (Ref: Para. 28)

A132. Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty. Routine, non-complex transactions that are subject to systematic processing are less likely to give rise to significant risks.

A133. Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:
   - Greater management intervention to specify the accounting treatment.
   - Greater manual intervention for data collection and processing.
   - Complex calculations or accounting principles.
   - The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.
A134. Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

A135. ISA 330\(^{40}\) describes the consequences for further audit procedures of identifying a risk as significant.\(^{41}\)

Significant risks relating to the risks of material misstatement due to fraud

A136. ISA 240 provides further requirements and guidance in relation to the identification and assessment of the risks of material misstatement due to fraud.\(^{42}\)

Notwithstanding that ISA 600 does not contain guidance relating to the identification of significant risks in a group context, the requirements to do so are included within ISA 315 (Revised) as detailed above, and would also be applicable to group audits. The GAWG is of the preliminary view that the requirements in ISA 315 (Revised) are sufficiently robust as they relate to identification and assessment of risks for all audits conducted in accordance with the ISAs, including significant risks. The GAWG suggests however that consideration be given to possibly clarifying requirements in or adding guidance to ISA 600 to help better support the application of the principles in ISA 315 (Revised) in group audit situations, e.g., how the significant risks identified in respect of the group financial statements can and should be considered and addressed when performing work at the component level.

The GAWG also suggests that further consideration be given to enhancing the standard (either through clarification or additions to the requirements or application material) to emphasize that significant risks identified by component auditors for a specific component should also be considered at the group level to determine whether the risks identified may apply more broadly to some or all of the other components (i.e., where the component auditors at other components may not necessarily have identified the same risk, but the facts and circumstances would appear to be similar) or for the group overall. Identification and assessment of significant risks is also linked to the identification of significant components (i.e., components where significant risks have been identified are considered significant components for the purposes of the standard) and strengthening the standard in this area may also help address the related issues as described above.

The intention is to obtain stakeholder views about the matters set out above through the GADP.

\(^{40}\) ISA 330, *The Auditor’s Responses to Assessed Risks*

\(^{41}\) ISA 330, paragraphs 15 and 21

\(^{42}\) ISA 240, paragraphs 25–27
32. Planning for the Group Engagement Team’s Involvement in the Work of Component Auditors

**Development of ISA 600**

The necessary involvement of the group engagement team in the work of component auditors was an issue that was heavily debated throughout the development of ISA 600. ED 2006 contained requirements detailing procedures to be performed by the group engagement team. Concern was expressed about the prescriptiveness of the requirements and also that not all of the requirements detailed applied in virtually all circumstances. To address this concern the requirements relating to the group engagement team’s involvement in general was moved to application material. However, the IAASB agreed that the requirement for the group engagement team to be involved in the work of the component auditor be retained, but allowed flexibility as to the nature, timing and extent of the involvement based on the circumstances. In particular, the application material in paragraph A47 in relation to the requirements for determining the type of work performed on the financial information of components, including the nature and extent of the group engagement team’s involvement in the work of the component auditor, identifies the factors that affect the type of work and the nature and extent of involvement. One of these factors is the group engagement team’s understanding of the component auditor, which is turn depends upon the factors in paragraph A33.

**Issues Identified**

- More clarity needed on the group engagement team’s documentation about the planned nature and extent of involvement in the work of the component auditors, and why such involvement can be considered appropriate in light of supporting the conclusion that sufficient appropriate audit evidence has been obtained. (ISA Implementation Monitoring)

- More clarity needed about the extent to which the group engagement team specifies and/or communicates risks to component auditors. (ISA Implementation Monitoring)

- Inadequate planning for sufficient involvement in the work of the component auditor (e.g., planned site visits and plans for adequate reviews.) (Audit Oversight Bodies)

**Relevant ISA References**

*Requirements*

...  

**Responding to Assessed Risks**

24. The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial statements. The group engagement team shall determine the type of work to be performed by the group engagement team, or the component auditors on its behalf, on the financial information of the components (see paragraphs 26–29). The group engagement team shall also determine the nature, timing and extent of its involvement in the work of the component auditors (see paragraphs 30–31).

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43 ISA 600, paragraph A55
Involvement in the Work Performed by Component Auditors (Ref: Para. A54–A55)

**Significant Components—Risk Assessment**

30. If a component auditor performs 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:

(a) Discussing with the component auditor or component management those of the component's business activities that are significant to the group;

(b) Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error; and

(c) Reviewing the component auditor’s documentation of identified significant risks of material misstatement of the group financial statements. Such documentation may take the form of a memorandum that reflects the component auditor’s conclusion with regard to the identified significant risks.

**Documentation**

50. The group engagement team shall include in the audit documentation the following matters:

(a) An analysis of components, indicating those that are significant, and the type of work performed on the financial information of the components.

(b) The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditors’ audit documentation and conclusions thereon.

(c) ...

**Application Material**

...

**Understanding the Component Auditor** (Ref: Para. 19)

*Group Engagement Team’s Procedures to Obtain an Understanding of the Component Auditor and Sources of Audit Evidence* (Ref: Para. 19)

A33. 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 are subject to common policies and procedures, for example:

- Whether the group engagement team and a component auditor share:
Common policies and procedures for performing the work (for example, audit methodologies);
○ Common quality control policies and procedures; or
○ Common monitoring policies and procedures.

- The consistency or similarity of:
  ○ Laws and regulations or legal system;
  ○ Professional oversight, discipline, and external quality assurance;
  ○ Education and training;
  ○ Professional organizations and standards; or
  ○ Language and culture.

Responding to Assessed Risks

Determining the Type of Work to Be Performed on the Financial Information of Components (Ref: Para. 26–27)

A47. The group engagement team’s determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by:

(a) The significance of the component;
(b) The identified significant risks of material misstatement of the group financial statements;
(c) The group engagement team’s evaluation of the design of group-wide controls and determination whether they have been implemented; and
(d) The group engagement team’s understanding of the component auditor.

The diagram shows how the significance of the component affects the group engagement team’s determination of the type of work to be performed on the financial information of the component.

Involvement in the Work Performed by Component Auditors (Ref: Para. 30–31)

A54. Factors that may affect the group engagement team’s involvement in the work of the component auditor include:

(a) The significance of the component;
(b) The identified significant risks of material misstatement of the group financial statements; and
(c) The group engagement team’s understanding of the component auditor.

In the case of a significant component or identified significant risks, the group engagement team performs the procedures described in paragraphs 30–31. In the case of a component that is not a significant component, the nature, timing and extent of the group engagement team’s involvement in the work of the component auditor will vary based on the group engagement team’s involvement in the work of the component auditor.

ISA 230 paragraphs 8–11, and A6
understanding of that component auditor. The fact that the component is not a significant component becomes secondary. For example, even though a component is not considered a significant component, the group engagement team nevertheless may decide to be involved in the component auditor’s risk assessment, because it has less than serious concerns about the component auditor’s professional competency (for example, lack of industry specific knowledge), or the component auditor does not operate in an environment that actively oversees auditors.

A55. Forms of involvement in the work of a component auditor other than those described in paragraphs 30–31 and 42 may, based on the group engagement team’s understanding of the component auditor, include one or more of the following:

(a) Meeting with component management or the component auditors to obtain an understanding of the component and its environment.
(b) Reviewing the component auditors’ overall audit strategy and audit plan.
(c) Performing risk assessment procedures to identify and assess the risks of material misstatement at the component level. These may be performed with the component auditors, or by the group engagement team.
(d) Designing and performing further audit procedures. These may be designed and performed with the component auditors, or by the group engagement team.
(e) Participating in the closing and other key meetings between the component auditors and component management.
(f) Reviewing other relevant parts of the component auditors’ audit documentation.

Preliminary Views of the GAWG

The GAWG is of the preliminary view that consideration should be given to strengthening ISA 600 in this area, by potentially clarifying the requirements and application material to more explicitly explain the interactions between the group engagement team and the component auditor as it relates to the involvement of the group engagement team in work done by component auditors. In particular, revisions could include the need for more focus on the significant judgments\(^\text{45}\) that need to be made about the nature and extent of the involvement of the group engagement team in work done by component auditors, and importantly the need for adequate documentation thereof. In addition, the GAWG is of the view that more guidance clarifying the interrelationships between paragraphs 24, 30, A47, A54, and A33 of ISA 600 may assist auditors in applying professional judgment in determining the nature, timing and extent of their involvement and in reminding them of the fact that involvement of group engagement team's in the work of component auditors may involve significant judgments relevant to a significant matter that would need to be documented pursuant to ISA 230 paragraph 8(c).

\(^{45}\) ISA 230, paragraph A8 is intended to set out the documentation of significant matters and related significant professional judgments of the auditor
The broad range of circumstances around the group engagement team’s involvement in the work of the component auditor is not explicitly set out in the extant standard. For example, in some cases the component auditor may be a firm that has the same policies and procedures as the group engagement team, or may be from the same jurisdiction as the group engagement team, such that the group engagement team may therefore be able to use the work of the component auditor with a different nature and extent of involvement than in those situations in which the component auditor is from a firm that does not have the same policies and procedures or is from a different jurisdiction (i.e., the nature and extent of the group engagement team’s involvement in the work performed by that auditor would likely need to be greater).

The GAWG also notes that this may be an area where a Staff Publication may be useful to illustrate the links and clarify the relationship between various paragraphs in the standard as described above, and also provide some additional illustrations of the broad range of circumstances that may exist. For example, the nature, timing and extent of the involvement of the group engagement team in the work of the component auditor depends on various circumstances, and the group engagement team would need to consider paragraphs 19, 24, A33, A47 and A54(c) of ISA 600 when determining the extent of their involvement.

The GADP will seek stakeholder perspectives on these issues and the possible ways of addressing them.

### 33. Audit Procedures at the Component

<table>
<thead>
<tr>
<th>Development of ISA 600</th>
<th>Respondents to ED 2006 expressed concern about the lack of explicit requirements directed at component auditors. The IAASB had the view that the ISA addresses the responsibilities of the group engagement team and therefore the standard did not contain requirements directed at component auditors. ED 2006 also included lists of types of work to be performed on the financial information of components that were determined to be significant and the work to be performed on components that were determined not to be significant. Respondents to the ED felt that these lists should be moved to application material, however the IAASB was of the view that the types of work should be retained to ensure consistent application of the requirements. The related application material to these requirements was developed to address concerns on how to determine the type of work to be performed, but did not include discussion on the meaning of each type of work.</th>
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<tbody>
<tr>
<td>Issues Identified</td>
<td>• Insufficient guidance about what the audit of a component’s financial information means (e.g., do all ISAs apply if it is not an audit for statutory purposes). (ISA Implementation Monitoring)</td>
</tr>
</tbody>
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46 For example, should ISA 805, *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement*, apply when auditing one or more account balances, classes of transactions or disclosures? Likewise, does ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*, apply in its entirety for a “review of component financial information”?
More guidance needed about what ‘specified audit procedures’ means. (ISA Implementation Monitoring)

<table>
<thead>
<tr>
<th>Relevant ISA References</th>
<th>ISA 600 Requirements</th>
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<tr>
<td></td>
<td>Determining the Type of Work to Be Performed on the Financial Information of Components (Ref: Para. A47)</td>
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<tr>
<td></td>
<td><strong>Significant Components</strong></td>
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<td></td>
<td>26. For a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on its behalf, shall perform an audit of the financial information of the component using component materiality.</td>
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<tr>
<td></td>
<td>27. For a component that is significant because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, shall perform one or more of the following:</td>
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<tr>
<td></td>
<td>(a) An audit of the financial information of the component using component materiality.</td>
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<td>(b) An audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement of the group financial statements. (Ref: Para. A48)</td>
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<td></td>
<td>(c) Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements. (Ref: Para. A49)</td>
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<td></td>
<td><strong>Components that Are Not Significant Components</strong></td>
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<td></td>
<td>28. For components that are not significant components, the group engagement team shall perform analytical procedures at group level. (Ref: Para. A50)</td>
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<td></td>
<td>29. If the group engagement team does not consider that sufficient appropriate audit evidence on which to base the group audit opinion will be obtained from:</td>
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<td></td>
<td>(a) the work performed on the financial information of significant components;</td>
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<td></td>
<td>(b) the work performed on group-wide controls and the consolidation process; and</td>
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<td>(c) the analytical procedures performed at group level, the group engagement team shall select components that are not significant components and shall perform, or request a component auditor to perform, one or more of the following on the financial information of the individual components selected: (Ref: Para. A51–A53)</td>
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<td></td>
<td>- An audit of the financial information of the component using component materiality.</td>
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</table>

**47** ISA 600, paragraph 27(c)
An audit of one or more account balances, classes of transactions or disclosures.

A review of the financial information of the component using component materiality.

Specified procedures.

The group engagement team shall vary the selection of components over a period of time.

Application Material

Determining the Type of Work to Be Performed on the Financial Information of Components (Ref: Para. 26–27)

A47. The group engagement team’s determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by:

(a) The significance of the component;

(b) The identified significant risks of material misstatement of the group financial statements;

(c) The group engagement team’s evaluation of the design of group-wide controls and determination whether they have been implemented; and

(d) The group engagement team’s understanding of the component auditor.

The diagram shows how the significance of the component affects the group engagement team’s determination of the type of work to be performed on the financial information of the component. [Diagram omitted]

Significant Components (Ref: Para. 27(b)–(c))

A48. The group engagement team may identify a component as a significant component because that component is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances. In that case, the group engagement team may be able to identify the account balances, classes of transactions or disclosures affected by the likely significant risks. Where this is the case, the group engagement team may decide to perform, or request a component auditor to perform, an audit of only those account balances, classes of transactions or disclosures. For example, in the situation described in paragraph A6, the work on the financial information of the component may be limited to an audit of the account balances, classes of transactions and disclosures affected by the foreign exchange trading of that component. Where the group engagement team requests a component auditor to perform an audit of one or more specific account balances, classes of transactions or disclosures, the communication of the group engagement team (see paragraph 40) takes account of the fact that many financial statement items are interrelated.

A49. The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial statements.
For example, in the case of a likely significant risk of inventory obsolescence, the group engagement team may perform, or request a component auditor to perform, specified audit procedures on the valuation of inventory at a component that holds a large volume of potentially obsolete inventory, but that is not otherwise significant.

**Components that Are Not Significant Components (Ref: Para. 28–29)**

A50. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that there are no significant risks of material misstatement of the aggregated financial information of components that are not significant components.

..., A52. A review of the financial information of a component may be performed in accordance with International Standard on Review Engagements (ISRE) 2400\[48\] or ISRE 2410,\[49\] adapted as necessary in the circumstances. The group engagement team may also specify additional procedures to supplement this work.

<table>
<thead>
<tr>
<th>GAWG Views</th>
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<tbody>
<tr>
<td>The work performed at the component will depend on the circumstances under which the component auditor is performing the audit (e.g., it may be for group audit purposes only, or in addition may also be for statutory purposes with an auditor's report on the separate financial statements of the component being issued), which may result in different considerations about how the component auditors plan and perform their work in order to address the requirement to perform an audit of a significant component for the purposes of the group audit. Examples of differences in the audit procedures may include:</td>
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<tr>
<td>- That materiality for the component would likely be higher if not issuing an auditor's report on the statutory financial statements.</td>
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<tr>
<td>- That certain audit procedures may be performed centrally where a separate audit opinion is not being expressed on the component, for example the identification of, and procedures performed on litigation and claims or other account balances and disclosures; written representations may also be obtained for the group as whole rather than at the component level.</td>
</tr>
<tr>
<td>- When the only reporting on the component is to the group auditor (for example through a clearance memo), the component auditor may not apply the ISA reporting standards.</td>
</tr>
</tbody>
</table>

The GAWG is of the preliminary view that making the distinction between work done for the purposes of the group audit and work done to support a stand-alone opinion at the component level more clear, and providing more guidance on relevant considerations for the auditor in the different circumstances (for example clarifying...
that an audit of the financial information of a component may not necessarily mean applying all ISAs in all circumstances, or possibly even changing the term from “audit” to another term), may be helpful in addressing the issues that have been identified. The GAWG also notes that there are instances where some balances are audited centrally or in the aggregate and 'pushed' down to the component (as described above). Additional guidance about the implications for the work being performed by the component auditor in these circumstances may also be beneficial, including when standalone opinions are also required at the component level.

**Audit Client’s Use of a Shared Service Centre**

The GAWG notes that in the current environment, many entities are increasingly operating in integrated structures, such as situations where the transactions for all or many ‘components’ are processed centrally, e.g., through a shared service center. In such circumstances, different interpretations of what a ‘component’ is in relation to ISA 600 have resulted in inconsistent application of ISA 600. In addition, it has been noted that the use of shared service centers also gives rise to other challenges in a number of areas, including whether and how to treat the shared service center as a component, how to scope audit procedures to be performed at the shared service center, how these procedures can be integrated into the work performed by the group engagement team and the component auditor(s), and the form and extent of communication between the engagement team responsible for the work being done at the shared service center, the group engagement team and the component auditor(s). In practice, there is inconsistency in the work effort in these situations, sometimes depending on whether or not the shared service center has been separately identified as a component. The GAWG is of the view that further consideration is needed as to how to better address the use of shared service centers in ISA 600, and to potentially consider enhancing the requirements of providing additional guidance for such situations.

The GAWG is generally of the preliminary view that more clarity in the standard around the work of component auditor(s) is needed, including work effort on evolving group structures, and would look to stakeholders responding to the GADP to provide further views on these matters.

<table>
<thead>
<tr>
<th>34. <strong>Audit Approach Where there are Only Non- Significant Components, or a Large Number of Non- Significant Components</strong></th>
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<tbody>
<tr>
<td><strong>Development of ISA 600</strong></td>
</tr>
<tr>
<td>Issues Identified</td>
</tr>
<tr>
<td>---------------------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| Relevant ISA References | **ISA 600**  

**Requirements**  

...  

**Components that Are Not Significant Components**  

28. For components that are not significant components, the group engagement team shall perform analytical procedures at group level. *(Ref: Para. A50)*  

29. If the group engagement team does not consider that sufficient appropriate audit evidence on which to base the group audit opinion will be obtained from:  

(a) the work performed on the financial information of significant components;  

(b) the work performed on group-wide controls and the consolidation process; and  

(c) the analytical procedures performed at group level;  

the group engagement team shall select components that are not significant components and shall perform, one or more of the following on the financial information of the individual components selected: *(Ref: Para. A51—A53)*  

- An audit of the financial information of the component using component materiality.  
- An audit of one or more account balances, classes of transactions or disclosures.  
- A review of the financial information of the component using component materiality.  
- Specified procedures.  

The group engagement team shall vary the selection of components over a period of time.  

**Application Material**  

...  

**Expectation to Obtain Sufficient Appropriate Evidence** *(Ref: Para. 13)*  

A13. A group may consist of components not considered significant components. In these circumstances, the group engagement partner can reasonably expect to obtain sufficient appropriate evidence on which to base the group audit opinion if the group engagement team will be able to:  

(a) Perform the work on the financial information of some of these components; and  

(b) Be involved in the work performed by the component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.
Components that Are Not Significant Components (Ref: Para. 28–29)

A50. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that there are no significant risks of material misstatement of the aggregated financial information of components that are not significant components.

A51. The group engagement team's decision as to how many components to select in accordance with paragraph 29, which components to select, and the type of work to be performed on the financial information of the individual components selected may be affected by factors such as the following:

- The extent of audit evidence expected to be obtained on the financial information of the significant components.
- Whether the component has been newly formed or acquired.
- Whether significant changes have taken place in the component.
- Whether the internal audit function has performed work at the component and any effect of that work on the group audit.
- Whether the components apply common systems and processes.
- The operating effectiveness of group-wide controls.
- Abnormal fluctuations identified by analytical procedures performed at group level.
- The individual financial significance of, or the risk posed by, the component in comparison with other components within this category.
- Whether the component is subject to audit required by statute, regulation or for another reason.

Including an element of unpredictability in selecting components in this category may increase the likelihood of identifying material misstatement of the components' financial information. The selection of components is often varied on a cyclical basis.

A52. A review of the financial information of a component may be performed in accordance with International Standard on Review Engagements (ISRE) 2400 or ISRE 2410, adapted as necessary in the circumstances. The group engagement team may also specify additional procedures to supplement this work.

A53. As explained in paragraph A13, a group may consist only of components that are not significant components. In these circumstances, the group engagement team can obtain sufficient appropriate audit evidence on which to base the group audit opinion by determining the type of work to be performed on the financial information of the components in accordance with paragraph 29. It is unlikely that the group engagement team will obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement
team, or a component auditor, only tests group-wide controls and performs analytical procedures on the financial information of the components.

| Preliminary Views of the GAWG | In the preliminary view of the GAWG, the requirements of the standard with respect to performing work on “residual balances” (i.e., those pertaining to components that are not significant and not otherwise selected for testing) are not sufficiently clear or robust. Although paragraph 29 of ISA 600 requires consideration of additional work if the group engagement team does not consider that sufficient appropriate audit evidence will be obtained without also performing work at non-significant components, the standard does not require that in making this assessment, the group engagement team should consider whether risks of material misstatement remain that are not addressed by work done on significant components and at the group level. This issue is particularly relevant where there are a large number of entities, none of which are significant individually but that in aggregate represent risks of material misstatement. Therefore the GAWG suggests that the GADP explore stakeholder views about strengthening the requirements (with related application material) to address the auditor’s considerations about the work to be done on non-significant components, in addition to the work to be done on significant components. The GAWG is interested in learning more about how firms address these situations and whether NSS have any supplemental requirements or guidance.

The GAWG notes that paragraph A53 of ISA 600 touches upon the situation where a group may be comprised of components that are not significant components, however, there is limited guidance on how the group engagement team would determine which components would require procedures and how to determine when a sufficient number of components have been selected for the performance of procedures.

Further exploration of these issues in the GADP to seek stakeholder views will help in determining the need for and nature of potential changes to the standard in this area. |

| Further Information Gathering Needed | From firms:
Obtaining an understanding of firm guidance developed internally to address situations where the group consists entirely or largely of non-significant components to further understand how this is being dealt with in practice.

From others:
Obtain any guidance or standards\(^{50}\) that have been developed by others (e.g., by NSS) in this area to understand current practices and to provide input for an appropriate way forward. |

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\(^{50}\) For example, PCAOB Auditing Standard 9 paragraphs 11-13 include factors to be considered by the group engagement team in determining the components at which to perform audit procedures, the nature, timing and extent of those procedures and the factors relevant to the assessment of the risk of material misstatement associated with a particular component and the determination of necessary audit procedures.
Matters for IAASB Consideration

4. The IAASB is asked to consider the GAWG views presented in paragraphs 27–34, and provide its views on the matters noted.

5. The IAASB is asked whether there are any other matters relating to planning an audit of group financial statements that the GAWG should further consider.

Performing the Audit

35. The Group Engagement Team’s Involvement in the Consolidation Process

Development of ISA 600

ED 2006 explained that before accepting or continuing a group audit engagement, the group engagement team should have a reasonable expectation of obtaining sufficient appropriate audit evidence in relation to the consolidation process, which it was felt could be achieved by the group engagement team performing work on the consolidation process. This issue was not however a heavily debated area in the development of ISA 600.

Issues Identified

- More clarity needed for the group auditor’s work on the consolidation process. (ISA Implementation Monitoring)
- Concerns about overreliance on the component auditor for procedures over the consolidation. (Audit Oversight Bodies)

Relevant ISA References

ISA 600

Definitions

9. For the purposes of the ISAs, the following terms shall have the meanings attributed below:

   ...........................

   (i) Group engagement team—Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

Requirements

   ........................................

   Understanding the Group, Its Components, and Their Environments

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment. The group engagement team shall:

   (a) Enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage; and
(b) Obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: Para. A23–A29)

Responding to Assessed Risks

24. The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial statements. The group engagement team shall determine the type of work to be performed by the group engagement team, or the component auditors on its behalf, on the financial information of the components (see paragraphs 26–29). The group engagement team shall also determine the nature, timing and extent of its involvement in the work of the component auditors (see paragraphs 30–31).

25. If the nature, timing and extent of the work to be performed on the consolidation process or the financial information of the components are based on an expectation that group-wide controls are operating effectively, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the group engagement team shall test, or request a component auditor to test, the operating effectiveness of those controls.

Consolidation Process

32. In accordance with paragraph 17, the group engagement team obtains an understanding of group-wide controls and the consolidation process, including the instructions issued by group management to components. In accordance with paragraph 25, the group engagement team, or component auditor at the request of the group engagement team, tests the operating effectiveness of group-wide controls if the nature, timing and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

33. The group engagement team shall design and perform further audit procedures on the consolidation process to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This shall include evaluating whether all components have been included in the group financial statements.

34. The group engagement team shall evaluate the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications, and shall evaluate whether any fraud risk factors or indicators of possible management bias exist. (Ref: Para. A56)

35. If the financial information of a component has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group engagement team shall evaluate whether the financial
information of that component has been appropriately adjusted for purposes of preparing and presenting the group financial statements.

36. The group engagement team shall determine whether the financial information identified in the component auditor’s communication (see paragraph 41(c)) is the financial information that is incorporated in the group financial statements.

37. If the group financial statements include the financial statements of a component with a financial reporting period-end that differs from that of the group, the group engagement team shall evaluate whether appropriate adjustments have been made to those financial statements in accordance with the applicable financial reporting framework.

**Application Material**

... 

A11. The group engagement team’s understanding may include matters such as the following:

- The group structure, including both the legal and organizational structure (that is, how the group financial reporting system is organized).
- Components’ business activities that are significant to the group, including the industry and regulatory, economic and political environments in which those activities take place.
- The use of service organizations, including shared service centers.
- A description of group-wide controls.
- The complexity of the consolidation process.

(See also Appendix 2 for matters that may be considered when understanding the consolidation process and consolidation adjustments)

| Preliminary Views of the GAWG | The GAWG is of the preliminary view that ISA 600 includes appropriate requirements and application material addressing the understanding and evaluation of the consolidation process at the overall group level. However, the GAWG believes it would be helpful for the GADP to seek additional perspectives about whether more guidance could be included in the standard about consideration of internal control relevant to the audit and the entity’s financial reporting process used to prepare the consolidated financial statements. This could be done by more explicitly linking to the relevant requirements and guidance in ISA 315 (Revised), which requires the auditor to obtain an understanding of internal control relevant to the audit and the financial reporting process used to prepare the entity’s financial statements, and adding more guidance to ISA 600 to explain how this might apply in the context of a group audit. Consideration of changes in this area made by the recently completed Disclosures project may influence the approach taken. Also as part of understanding the entity, the group engagement team would need to determine whether consolidations of financial information take place at levels lower |

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51 ISA 315 (Revised), paragraph 18
than the overall group level (i.e., sub-consolidations). The GAWG notes that there is no guidance on the group engagement team’s expected involvement in any sub-consolidation processes, and consideration of the provision of such guidance may be appropriate. For example, such guidance could include a recognition that component auditors will likely not have the “full picture” of the group that the group engagement team has, and therefore may not be in a position to properly evaluate the completeness and accuracy of all consolidation adjustments at the sub-consolidation level.

This additional guidance could include links to, or build on, the requirements and guidance in ISA 220 in respect of the engagement partner’s responsibilities for the direction, supervision, performance and review of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements.

In addition, the GADP could explore stakeholder views about whether some aspects of the examples of matters to consider when understanding the consolidation process currently contained in Appendix 2 of ISA 600 could be considered for elevation in status to application material or to requirements, encompassing both the overall group consolidation level and any sub-consolidation levels.

<table>
<thead>
<tr>
<th>Further Information Gathering Needed</th>
<th>From firms</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>More information about the issues and challenges that are being experienced in practice by group auditors relating to sub-consolidations will need to be explored to understand the nature of such issues and challenges, and therefore determine an appropriate way forward.</td>
</tr>
<tr>
<td></td>
<td>From audit oversight bodies</td>
</tr>
<tr>
<td></td>
<td>To the extent available, any additional information that may be helpful to the GAWG in further understanding the issues relating to perceived deficiencies in auditing the consolidation process (including whether the issues is at the sub-consolidation level), as well as views about whether clarifying or strengthening the requirements or developing additional application material for the necessary documentation by the auditor to evidence the judgments made in relation to the consolidation process (or sub-consolidation as applicable) would also be beneficial.</td>
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</table>

**Matters for IAASB Consideration**

6. The IAASB is asked to consider the GAWG views presented in paragraph 35, and provide its views on the matters noted.

7. The IAASB is asked whether there are any other matters relating to the performance of procedures by the group engagement team as it relates to group audits that the GAWG should further consider.
## Review and Evaluation of the Work of Component Auditors

### Development of ISA 600

In developing the standard, there was significant discussion around the nature, timing and extent of procedures to be performed by the group engagement team in respect of all aspects of the component auditor’s work. It was acknowledged that the extent of the involvement would vary based on the group engagement team’s evaluation of the component auditor, the environment in which the component auditor operates, the significance of the component being audited by the component auditor and the existence of common policies and procedures between the group engagement team and the component auditor. The requirements to base the group engagement team’s decision to review relevant parts of the component auditor’s documentation were revised as the standard was developed, allowing flexibility as to the extent of the review determined by the group engagement team’s assessment of the circumstances of the engagement.\(^5\) This is also intrinsically linked to evaluating the sufficiency and appropriateness of audit evidence obtained (see below).

### Issues Identified

- The need for more guidance on when the group engagement team needs to review the working papers of the component, the nature and extent of the review, and how to evidence the nature and extent of the review. (*ISA Implementation Monitoring*)
- Insufficient review of the component auditor’s procedures. (*Audit Oversight Bodies*)

### Relevant ISA References

#### ISA 600

**Requirements**

...  

**Communication with the Component Auditor**

41. The group engagement team shall request the component auditor to communicate matters relevant to the group team’s conclusion with regard to the group audit. Such communications shall include: (Ref: Para. A60)

   (a) Whether the component auditor has complied with ethical requirements that are relevant to the group audit, including independence and professional competence;

   (b) Whether the component auditor has complied with the group engagement team’s requirements;

   (c) Identification of the financial information of the component on which the component auditor is reporting;

   (d) Information on instances of non-compliance with laws or regulations that could give rise to a material misstatement of the group financial statements;

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\(^5\) ISA 600, paragraphs 42 and A61
(e) A list of uncorrected misstatements of the financial information of the component (the list need not include misstatements that are below the threshold for clearly trivial misstatements communicated by the group engagement team (see paragraph 40(c));

(f) Indicators of possible management bias;

(g) Description of any identified significant deficiencies in internal control at the component level;

(h) Other significant matters that the component auditor communicated or expects to communicate to those charged with governance of the component, including fraud or suspected fraud involving component management, employees who have significant roles in internal control at the component level or others where the fraud resulted in a material misstatement of the financial information of the component;

(i) Any other matters that may be relevant to the group audit, or that the component auditor wishes to draw to the attention of the group engagement team, including expectations noted in the written representations that the component auditor requested from component management; and

(j) The component auditor’s overall findings, conclusions or opinion.

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

42. The group engagement team shall evaluate the component auditor’s communication (see paragraph 41). The group engagement team shall:

(a) Discuss significant matters arising from that evaluation with the component auditor, component management or group management, as appropriate; and

(b) Determine whether it is necessary to review other relevant parts of the component auditor’s audit documentation. (Ref: Para. A61)

Application Material

…

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

42(b) Reviewing the Component Auditor’s Audit Documentation (Ref: Para. 42(b))

A61. What parts of the audit documentation of the component auditor will be relevant to the group audit may vary depending on the circumstances. Often the focus is on audit documentation that is relevant to the significant risks of material misstatement of the group financial statements. The extent of the review may be affected by the fact that the component auditor’s audit documentation has been subjected to the component auditor’s firm’s review procedures.
The GAWG observes that the requirement in paragraph 42 of ISA 600 to evaluate the component auditor’s work may be impacted by issues that restrict or otherwise complicate the auditor’s access to the working papers (see discussion about access issues above). However, the GAWG is of the preliminary view that challenges in this area are likely due to more than access issues. Accordingly, the GADP believes that it would be appropriate to seek additional perspectives about whether and how the requirements and guidance may be clarified or expanded to further address the nature and extent of this review.

For example, to encourage the group engagement team to critically review the work of the component auditor to fully understand the extent and robustness of the procedures performed by the component auditor, the requirements could potentially be revised to provide more clarity on the procedures that the group engagement team would perform in the review. However, care will be needed to ensure that the extent of the review required by the group engagement team does not exceed that which would be undertaken on a non-group audit.

In addition, the GAWG also believe that issues may sometimes arise from insufficient documentation, relating to the group engagement team’s review of the component’s work papers and conclusions, being included in the audit documentation of the group audit file. In particular, significant judgments that are made by the group engagement team in relation to this review may in some cases not be properly documented in the group audit file. Accordingly, the GAWG is of the preliminary view that further consideration could also be given to strengthening the documentation requirements regarding the review, including how the review was performed by the group engagement team and the documents reviewed, and specifically linking to the requirements in ISA 230.53 Alternatively, enhanced requirements to strengthen the evidence regarding this review could also be explored. These matters need to be considered in light of the fact that the work of the component auditor is likely already reviewed by the engagement partner responsible for the work at the component. Consequently, the nature and depth of the review should, in principle, not be significantly different from the review of a key audit partner’s work by the engagement partner in an audit that is not a group audit.

The GAWG also believes that additional guidance on the nature, timing and extent of the procedures that the group engagement team should perform on the work of the component auditor would be helpful. This could be explored through the use of examples of the types and extent of procedures that would be expected to be performed in varying group engagement scenarios, such as when the component auditor uses common policies and procedures, or methodologies, as the group audit engagement team and when it does not. The guidance could either be in the application material or a non-authoritative Staff publication, and views on the need for, and the most appropriate place for, such guidance will be sought in the GADP.

<table>
<thead>
<tr>
<th>Preliminary Views of the GAWG</th>
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<tr>
<td>The GAWG observes that the requirement in paragraph 42 of ISA 600 to evaluate the component auditor’s work may be impacted by issues that restrict or otherwise complicate the auditor’s access to the working papers (see discussion about access issues above). However, the GAWG is of the preliminary view that challenges in this area are likely due to more than access issues. Accordingly, the GADP believes that it would be appropriate to seek additional perspectives about whether and how the requirements and guidance may be clarified or expanded to further address the nature and extent of this review.</td>
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53 ISA 230, paragraph 8
<table>
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<tr>
<th>37. The Impact of the Component Auditor’s Findings on the Group Audit</th>
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<tbody>
<tr>
<td><strong>Development of ISA 600</strong></td>
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<tr>
<td>Subsequent to comments received to ED 2005 concerning strengthening the group engagement team’s procedures in respect to involvement in the work of the component auditor, it was agreed that the group engagement team’s evaluation of the adequacy of the component auditors’ work would help the group engagement team conclude about whether sufficient, appropriate audit evidence for the group audit as a whole has been obtained.</td>
</tr>
<tr>
<td><strong>Issues Identified</strong></td>
</tr>
<tr>
<td>Insufficient consideration of the effects on the group audit of the component auditor’s findings, including the evaluation of whether sufficient appropriate audit evidence has been obtained. (Audit Oversight Bodies)</td>
</tr>
<tr>
<td><strong>Relevant ISA References</strong></td>
</tr>
<tr>
<td><strong>ISA 600 Requirements</strong></td>
</tr>
<tr>
<td>43. If the group engagement team concludes that the work of the component auditor is insufficient, the group engagement team shall determine what additional procedures are to be performed, and whether they are to be performed by the component auditor or by the group engagement team.</td>
</tr>
<tr>
<td><strong>Sufficiency and Appropriateness of Audit Evidence</strong></td>
</tr>
<tr>
<td>44. The auditor is required to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. The group engagement team shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the component auditors on the financial information of the components, on which to base the group audit opinion. (Ref: Para. A62)</td>
</tr>
<tr>
<td><strong>Application Material</strong></td>
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<td></td>
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<tr>
<td><strong>Sufficiency and Appropriateness of Audit Evidence</strong> (Ref: Para. 44–45)</td>
</tr>
<tr>
<td>A62. If the group engagement team concludes that sufficient appropriate audit evidence on which to base the group audit opinion has not been obtained, the group engagement team may request the component auditor to perform additional procedures. If this is not feasible, the group engagement team may perform its own procedures on the financial information of the component.</td>
</tr>
<tr>
<td><strong>Preliminary Views of the GAWG</strong></td>
</tr>
<tr>
<td>As illustrated above, there is a requirement to obtain sufficient appropriate audit evidence to support the audit opinion. The issue may be due to one or a combination of the following:</td>
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54 ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, paragraph 17
• Insufficient documentation of the group engagement team’s considerations and significant judgments about the sufficiency and appropriateness of the evidence from the component auditor to support the group audit opinion.
• Insufficient consideration or documentation of the broader implications for the group audit from the results of the component auditor’s work (e.g., evidence that the group auditor has considered whether a component auditor finding for one component gave rise to heightened risk where similar circumstances exist in other components).

The GAWG is of the view that the issue needs to be further understood to determine an appropriate way forward.

<table>
<thead>
<tr>
<th>Further Information Gathering Needed</th>
<th>From firms: Exploring firms’ views on this issue, including how firms may have addressed inspection findings on this issue. From audit oversight bodies: To the extent available, any additional information about the causal factors giving rise to this issue.</th>
</tr>
</thead>
</table>

### 38. Communication Between the Component Auditor and the Group Engagement Team

#### Development of ISA 600
In finalizing the standard, consideration was given to concerns expressed by respondents to ED 2006 in respect of the prescriptive nature of the requirements concerning communication between the component auditor and the group engagement team. As a result, changes were made to allow for flexibility in the group engagement team’s method of communication with the component auditor. Application material was specifically added to explain that communications may not necessarily be in writing. However, such communications were still required to be on a timely basis and include a request that the component auditor communicate matters relevant to the group audit to the group engagement team.

#### Issues Identified
• More guidance is needed on the communication between the group engagement team and the component auditor to ensure more consistency in these communications. *(ISA Implementation Monitoring)*
• Insufficient communication between the group engagement team and the component auditor, in particular discussions regarding the findings of the component auditor. *(Audit Oversight Bodies)*

#### Relevant ISA References
ISA 600

**Requirements**

..., Communication with the Component Auditor

40. The group engagement team shall communicate its requirements to the component auditor on a timely basis. This communication shall set out the work to be performed, the use to be made of that work, and the form and content of the component auditor’s communication with the group
engagement team. It shall also include the following: (Ref: Para. A57, A58, A60)

(a) A request that the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, confirms that the component auditor will cooperate with the group engagement team. (Ref: Para. A59)

(b) The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.

(c) In the case of an audit or review of the financial information of the component, component materiality (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.

(d) Identified significant risks of material misstatement of the group financial statements, due to fraud or error, which are relevant to the work of the component auditor. The group engagement team shall request the component auditor to communicate on a timely basis any other identified significant risks of material misstatement of the group financial statements, due to fraud or error, in the component, and the component auditor’s responses to such risks.

(e) A list of related parties prepared by group management, and any other related parties of which the group engagement team is aware. The group engagement team shall request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team shall determine whether to identify such additional related parties to other component auditors.

41. The group engagement team shall request the component auditor to communicate matters relevant to the group engagement team’s conclusion with regard to the group audit. Such communication shall include: (Ref: Para. A60)

(a) Whether the component auditor has complied with ethical requirements that are relevant to the group audit, including independence and professional competence;

(b) Whether the component auditor has complied with the group engagement team’s requirements;

(c) Identification of the financial information of the component on which the component auditor is reporting;

(d) Information on instances of non-compliance with laws or regulations that could give rise to a material misstatement of the group financial statements;

(e) A list of uncorrected misstatements of the financial information of the component (the list need not include misstatements that are below the
threshold for clearly trivial misstatements communicated by the group
engagement team (see paragraph 40(c));

(f) Indicators of possible management bias;

(g) Description of any identified significant deficiencies in internal control at
the component level;

(h) Other significant matters that the component auditor communicated or
expects to communicate to those charged with governance of the
component, including fraud or suspected fraud involving component
management, employees who have significant roles in internal control at
the component level or others where the fraud resulted in a material
misstatement of the financial information of the component;

(i) Any other matters that may be relevant to the group audit, or that the
component auditor wishes to draw to the attention of the group
engagement team, including exceptions noted in the written
representations that the component auditor requested from component
management; and

(j) The component auditor’s overall findings, conclusions or opinion.

50. The group engagement team shall include in the audit documentation the
following matters:

   …

   (b) The nature, timing and extent of the group engagement team’s
   involvement in the work performed by the component auditors on
   significant components including, where applicable, the group
   engagement team’s review of relevant parts of the component auditors’
documentation and conclusions thereon.

   (c) Written communication between the group engagement team and the
   component auditors about the group engagement team’s requirements.

**Application Material**

   …

**Communication with the Component Auditor** (Ref: Para. 40–41)

A57. If effective two-way communication between the group engagement team and
the component auditors does not exist, there is a risk that the group
engagement team may not obtain sufficient appropriate audit evidence on
which to base the group audit opinion. Clear and timely communication of the
group engagement team’s requirements forms the basis of effective two-way
communication between the group engagement team and the component
auditor.

A58. The group engagement team’s requirements are often communicated in a
letter of instruction. Appendix 5 contains guidance on required and additional
matters that may be included in such a letter of instruction. The component
auditor’s communication with the group engagement team often takes the
form of a memorandum or report of work performed. Communication between
| Preliminary Views of the GAWG | Notwithstanding the existing requirements and guidance, the GAWG is of the preliminary view that the requirements around communication in ISA 600 could be strengthened, in particular in relation to the ‘feedback loop’ of communication, i.e., such that there is more interactive communication required between the group engagement team and component auditor as the group engagement team plans, reviews and assesses the work performed by the component auditor. Two-way communication at all stages of the audit would enable the group engagement team to better understand if the instructions provided to the component auditor have been fully understood and complied with. It may also help the group engagement team better understand the results of the procedures performed and assist them with evaluating the sufficiency and appropriateness of the audit evidence obtained for the purposes of the group audit opinion.

Further, the application material relating to the existing requirements around communication with the component auditor could be supplemented to explain more precisely what the requirement is intended to cover and could include examples of procedures that may be appropriate in the circumstances. For example, ISA 600 requires timely communication between the group engagement team and the component engagement team, however it doesn’t then explain what is meant by timely. ISA 260 guidance in respect of the timing of communications could be used as a basis to provide such an explanation in ISA 600.

In addition, further application material could also be considered to specifically point to the documentation of all significant communications and not just focus on the inclusion of written communications. |

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55 ISA 260, *Communication with Those Charged With Governance*
The GADP will seek stakeholder views as to whether a strengthening of the requirements and additional guidance will be useful to address the relevant issues identified above.

The GAWG also notes that currently the requirement in ISA 600 only specifies documentation of the group engagement team’s involvement in the work performed by the component auditors on significant components. The GAWG believes that the GADP could also seek the views of stakeholders’ about whether this should be extended to the engagement team’s involvement in the work of component auditors on all components where work is performed in support of the audit opinion.

**Matters for IAASB Consideration**

8. The IAASB is asked to consider the GAWG views presented in paragraphs 36‒38, and provide its views on the matters noted.

9. The IAASB is asked whether there are any other matters relating to the review and evaluation of by the group engagement team that the GAWG should further consider.

**Other Areas to Explore**

39. In its discussions on the matters noted above, the GAWG also identified further areas to explore and plans to undertake additional information gathering to determine whether these matters should be included in the GADP:

   (a) Practices relating to different audit delivery models and the impact on the standards or other Board documents (this will likely be done in coordination with the Quality Control Working Group).

   (b) The application of the standards to ‘fund of funds’ situations (including a determination as to whether or not ISA 600 would apply in these circumstances, and if not, why not or if so, how it might be applied).

   (c) Work being undertaken by other standard setters in this area, in particular the PCAOB in the US, and standard setters in the Netherlands and Canada, and the impact that these efforts may have on the ISAs.

   (d) The pervasiveness of issues related to the component auditor being requested to provide information to the group engagement team when the group engagement team has had no involvement in the audit of the component. Understanding this matter will help guide whether additional application material for these circumstances would be appropriate.

40. At the March 2015 IAASB CAG meeting, the ability of the group engagement team to use a component auditor’s statutory report as part of the evidence considered in issuing the group auditor’s report was raised. The GAWG believes that further exploration and consideration of the possibility of making reference to the work or report of another auditor in the auditor’s report on the group financial statements, including obtaining stakeholder perspectives through the GADP, may be beneficial. This exploration would include consideration of the procedures group auditors would need to undertake to enable themselves to be able to use this option, and in which circumstances it may be appropriate. Relevant considerations may include the ability of the auditor to use audited financial statements as
audit evidence in appropriate circumstances, which would not be seen as a "division of responsibility", but rather a situation where the group engagement partner remains responsible overall for the audit of the group financial statements and the related auditor’s report and in reporting, provides transparency as to how sufficient appropriate audit evidence has been obtained. The GAWG plans to further explore and understand the requirements and guidance issued by other jurisdictions who allow this in certain circumstances (e.g., such as in the US).

Matter for IAASB Consideration

10. IAASB members are asked for views on the additional areas to explore as set out in paragraphs 39–40 above.

11. Are there any other matters that the GAWG should take into account as it develops the GADP?