

Invitation to Comment: Enhancing Audit Quality in the Public Interest—A Focus on Quality Control, Group Audits and Professional Skepticism**Purpose of this Invitation to Comment**

The purpose of this Invitation to Comment (ITC) is to explore how the IAASB might best respond in the public interest to calls to enhance audit quality, particularly in the context of the IAASB's 2015–2016 priority projects relating to Professional Skepticism, Quality Control and Group Audits.

This consultation is being performed at a preliminary stage of work on these topics, as the IAASB has learned that early consultation on directional issues and public interest matters to be addressed facilitates more effective standard setting.

About this Consultation

This ITC provides a summary of the influencing factors that are driving the IAASB to consider changes to the International Standards on Auditing and Quality Control (ISAs and ISQC 1)¹ to enhance audit quality. It sets out details in relation to issues identified relating to Professional Skepticism, Quality Control and Group Audits, makes specific reference to the requirements and guidance in the current suite of ISAs and ISQC 1, and describes possible actions that the IAASB may take to address the issues. In describing these actions, the IAASB is not limiting its consideration of other actions that may be more effective, or appropriate, and is looking to stakeholders responding to this ITC for input on these matters.

The possible actions set out in this ITC relate predominantly to standard-setting activities of the IAASB, specifically whether the improvements or enhancements should be in the requirements, application material or both. However, respondents may have the view that alternative actions should be considered. Examples of some alternative actions that the IAASB or others might undertake include:

- Development of non-authoritative guidance by the IAASB (such as an International Auditing Practice Note (IAPN)).
- Development of non-authoritative IAASB Staff publications (such as a Staff Question and Answer publication).
- Development of relevant guidance on particular topics by national standard setters (NSS) and IFAC member bodies.
- Development of information papers on particular topics by the Forum of Firms.
- Development of training or educational materials for auditors (for example, by the IFAC Small and Medium Practices (SMP) Committee or others).

¹ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

Interaction of the ITC with the Overview

The IAASB's *Overview of the IAASB's Invitation to Comment* (the Overview) introduces the matters set out in this ITC. The Overview is designed to facilitate responses from users and preparers of financial statements as well as audit committees and their representative organizations. The Overview describes the public interest issues the IAASB is seeking to address in the context of its three priority projects that are included in this ITC. This ITC is generally intended to facilitate responses from firms, regulators and audit oversight bodies, NSS, member bodies and others interested in the more detailed aspects of the consultation. The Overview includes references to this ITC to where more details about the matters described in the Overview can be found. If respondents are commenting on matters in this document there is no need to comment on anything further in the Overview.

Being Heard

- To provide input, submit a response by May [X], 2016 (all responses will be made available on the IAASB's website)
- Initiate or attend an event in your jurisdiction where matters relevant to this consultation will be discussed
- For more information, visit <http://www.iaasb.org/focus-audit-quality>

Questions for Respondents

Relevant questions for each section can be found throughout this ITC. A full list of all questions in this ITC can be found on pages 103–110.

In describing any alternatives that the IAASB should consider, respondents are requested to indicate any specific alternative actions that would be appropriate as well as providing views as to whom respondents believe should be responsible for the actions.

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Introduction

1. The clarified ISAs and ISQC 1 serve a fundamental role in underpinning audit quality and users' confidence in the audit and financial reporting. It is therefore in the public interest that these standards form the basis for high-quality, valuable and relevant audits, with appropriate guidance to support the principles-based requirements, such that they are capable of being implemented consistently and on a global basis. The IAASB recognizes the importance of being aware as to whether its public interest objectives are being achieved and is committed to proactively seeking relevant information through ongoing outreach activities and periodic post-implementation reviews.
2. The finalization of the IAASB's efforts to clarify the ISAs and International Standard on Quality Control, ISQC, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, was an important step in the IAASB's commitment to audit quality. Shortly after the clarified ISAs became effective in 2009, the Board embarked on its first post-implementation review (the "ISA Implementation Monitoring" project) that was completed in July 2013.

[PLACEHOLDER FOR PICTURE]

IAASB’s ISA Implementation Monitoring project	Ongoing Outreach
<p>The July 2013 findings from the ISA Implementation Monitoring project indicated the need for improvement to aspects of certain ISAs to achieve greater consistency and effectiveness in their application. These findings were informed by firms’, NSS and member bodies’ experiences with implementing the clarified ISAs.</p>	<p>The IAASB’s rigorous outreach program, in particular its collaboration with audit inspection bodies and regulators, as well as ongoing dialogue with firms, NSS and others, continues to keep the IAASB apprised of areas where improvements to its standards may be needed, or where other actions to enhance auditor performance may be appropriate.</p>
	
<p>Public consultation on IAASB’s Strategy for 2015–2019 and Work Plan for 2015–2016</p>	
	
<p>IAASB’s Strategy for 2015–2019 (Strategy)</p> <p>The IAASB’s Strategy sets out three strategic objectives, with the first and most important strategic objective being <i>to ensure that the ISAs continue to form the basis for high-quality, valuable, and relevant audits conducted worldwide by responding on a timely basis to issues noted in practice and emerging developments.</i></p>	
<p>IAASB’s Work Plan for 2015–2016 (“the Work Plan”)</p> <p>The IAASB’s public consultation on its current Work Plan highlighted its commitment to addressing significant findings from the ISA Implementation Monitoring project on a timely basis. Stakeholders responding to that consultation urged the IAASB to do so as a matter of public interest, and their input formed the basis for the IAASB’s determination as to which projects to include in the current Work Plan. With the strategic objectives in mind, the Work Plan gave priority to:</p> <ul style="list-style-type: none"> • Quality control; • Group audits; • Professional skepticism; and • Special considerations in audits of financial institutions (including a potential revision of ISA 540).² 	

² The financial institutions project is not directly addressed by this consultation. At its December 2015 meeting, the IAASB [approved] a project proposal to revise ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

Taking Action in the Public Interest

3. In its consideration of the three projects addressed by this consultation (i.e., professional skepticism, quality control and group audits), the IAASB is focused on taking action in the public interest. In identifying the important matters to be addressed, and in framing the related issues, the possible standard-setting and other activities described in this consultation, the IAASB has considered various questions. The matters identified and the questions considered include:
- *Enhancing the ISAs to be appropriate for the evolving and complex business environment of today and in anticipation of increasing complexity and ongoing evolution into the future* – Do the ISAs contain robust, yet sufficiently flexible, requirements and guidance to drive appropriate auditor performance (including the role and responsibilities of the engagement partner) and promote audit quality in the varied and complex scenarios that arise today, and that are likely to continue to evolve in the future? For example, how can improvements be made to the ISAs, particularly ISA 600,³ to strengthen the quality of multi-national audits, taking into account challenges that may arise from law, regulation or the impact of factors such as auditor rotation and the use of audit delivery models (ADMs)?
 - *Facilitating firm leaders taking responsibility for implementing a proactive approach to quality management* – What can be done to encourage firms to take a broader approach toward managing quality, including in terms of how leadership of the firm proactively leads and manages their businesses, promoting a culture of quality throughout their organizations and continuous improvement to quality through effective monitoring and remediation? Could a fresh look at the form, structure and requirements in the IAASB’s standards addressing the firm’s system of quality control have a positive effect on audit quality by promoting and better supporting the design of a firm’s approach to quality management that is responsive to risks of the firm not meeting its quality objectives? Should the scope of required engagement quality control reviews be expanded (i.e., beyond listed entities) and should the roles and responsibilities of the engagement quality control reviewer be enhanced?
 - *Networks, Firms, Remediation Processes* – Is there sufficient clarity regarding the linkages between a firm and, where applicable, the network within which it operates, particularly as to what is needed when the firm is placing reliance on network policies and procedures to meet quality control obligations at the engagement and firm levels? Would enhancing requirements as to how firms, and the networks within which they operate, communicate internally and how they respond to internal and external inspection findings positively impact audit quality?
 - *Fostering an independent, challenging, and skeptical mindset of the auditor* – Can the fundamental concept of professional skepticism be better reinforced within the ISAs or through other activities by the IAASB or others and, if so, how? Can the responsibilities of the engagement partner in this regard – as the champion for audit quality – be further enhanced?
 - *Communication, Interactions, and Documentation* – Would strengthening the ISAs to enhance interactions and communication, for example between engagement partners and engagement teams and others involved in the audit, or between group engagement teams and component auditors contribute to more effective audits? How might these essential interactions and communications be more appropriately evidenced in an audit file?
 - *Transparency and observability* – Could initiatives be undertaken to explore how investors and other users of audited financial statements might be provided with greater insight into a firm’s system of quality control (e.g., in acknowledgement of the developments in firm-level transparency reporting)?

Note: Although this consultation includes specific questions for respondents to consider in providing input on this consultation, the above questions used by the IAASB in framing the issues may help respondents in formulating or informing their views.

³ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

4. The IAASB recognizes that its standards apply to a wide range of circumstances in diverse jurisdictions and that the circumstances in which they are applied continue to evolve. Any changes to the standards will therefore need be made in the context of maintaining their ongoing relevance, while retaining the fundamental principles of an audit and overall objectives of the auditor,⁴ including the application of appropriate professional judgment and professional skepticism.
5. An important part of this consultation is to seek to obtain input about respondents' understanding of the causal factors of issues (including inspection findings) related to the priority projects, and in the context of that understanding, solicit views about potential improvements to the related standards that might be necessary. Relevant input from respondents will help the IAASB determine what issues it can address and how best to do so. For example, this input will inform the IAASB's efforts to explore potential changes to the ISAs and ISQC 1 to enhance auditor performance, as well as its consideration of whether there are other actions by the IAASB that would be appropriate and effective.
6. At the same time the IAASB notes that there are others that can likely also undertake actions that would complement its standard-setting actions (e.g., regulators and audit oversight bodies, audit committees, policymakers, NSS, member bodies or firms) in relation to the three topics of professional skepticism, quality control and group audits. The IAASB therefore welcomes views from its stakeholders about where others can proactively take steps to meaningfully enhance audit quality in relation to these topics. The IAASB believes that facilitating cooperation and interaction among its stakeholders on matters related to enhancing audit quality is an important part of its remit as a global standard setter.
7. It is expected that input from respondents will form the basis for project proposals relating to quality control and group audits. After these project proposals for standard-setting activities are approved by the IAASB, the relevant Task Forces will commence work to developing changes to the ISAs and ISQC 1. Expected actions in relation to the professional skepticism project are further explained in paragraphs 17-34
8. The expected timeline for the projects on quality control and group audits is as follows:



⁴ In conducting an audit of financial statements, the overall objectives of the auditor are: (a) to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, and (b) to report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings.

Audit Quality: The Interaction between the IAASB’s Work and Its Stakeholders

What Is a Quality Audit?

The term **audit quality** encompasses the key elements that create an environment which maximizes the likelihood that **quality audits** are performed on a consistent basis.

The objective of an audit of financial statements is for the auditor to form an opinion on the financial statements based on having obtained sufficient appropriate audit evidence about whether the financial statements are free from material misstatement and to report in accordance with the auditor’s findings.

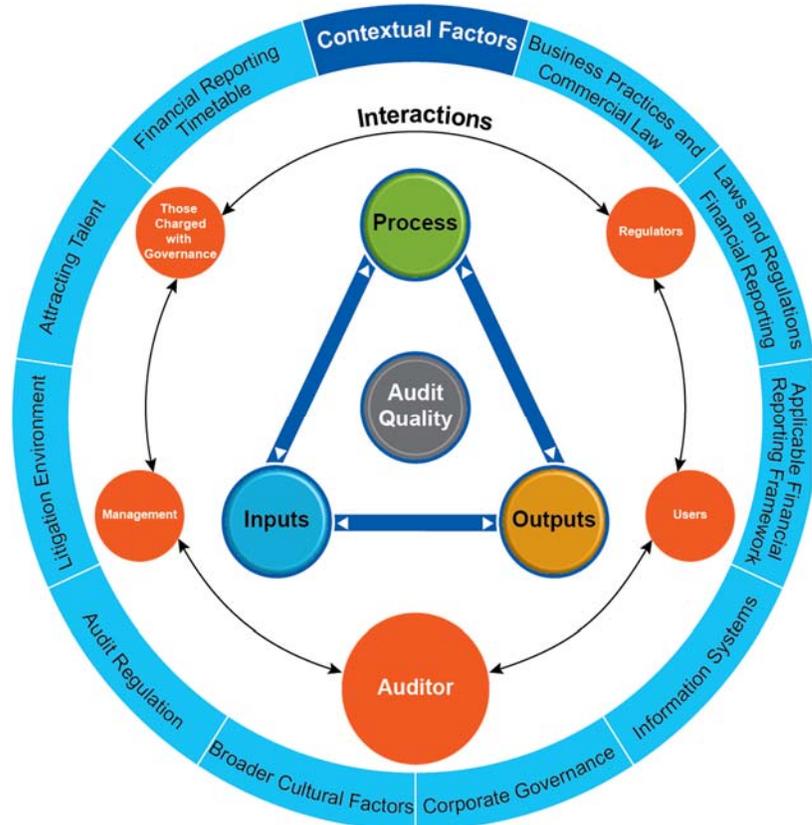
A **quality audit** is likely to have been achieved by an engagement team that:

- ❖ Exhibited appropriate values, ethics and attitudes;
- ❖ Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
- ❖ Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards;
- ❖ Provided useful and timely reports; and
- ❖ Interacted appropriately with relevant stakeholders.

- Paragraphs 1–2 of the IAASB’s Framework for Audit Quality (2014)

9. The IAASB’s [Framework for Audit Quality](#) (the AQ Framework) was developed to raise awareness of the key elements of audit quality, encourage stakeholders to explore ways to improve audit quality, and facilitate dialogue between key stakeholders⁵ on the topic. The AQ Framework also highlights important inputs, processes and outputs—with quality audits involving auditors applying rigorous processes and quality control procedures that comply with law, regulation and applicable standards.

10. The AQ Framework also highlights that responsibility for performing quality audits of financial statements rests with auditors.



⁵ In the graphic, “those charged with governance” refers to those who have responsibility for overseeing strategic direction of the entity and obligations related to the accountability of the entity, including oversight of the financial reporting process (e.g., Boards of Directors, Audit Committees or similar). Governance structures vary, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics.

The primary output of an audit is an auditor's opinion that provides users with confidence as to the reliability of the audited financial statements. For the majority of users, the absence of a modified auditor's opinion is an important signal about the reliability of the financial information.

- Paragraph 20 of the AQ Framework

Audits need to be performed in accordance with auditing standards and are subject to the firm's quality control procedures, which comply with ISQC 1. These provide the foundation for a disciplined approach to risk assessment, planning, performing audit procedures and ultimately forming and expressing an opinion. Sometimes, firms' methodologies and internal policies and procedures provide more specific guidance on matters such as who undertakes specific activities, internal consultation requirements, and documentation formats.

- Paragraph 12 of the AQ Framework

11. In recent years, audit oversight bodies have intensified inspection and other activities, including their level of coordination on an international basis. Publicly reported inspection findings consistently highlight aspects of the audit where improvements to audit quality are needed. For example, the International Forum of Independent Audit Regulators' (IFIAR) [2014 Summary of Inspection Findings](#) highlights IFIAR's view of persistent deficiencies in important aspects of audits, including with respect to firms' systems of quality control, quality control at the engagement level, performance of group audits and application of professional skepticism. The themes from external inspections as communicated by regulators and audit oversight bodies are largely consistent with what the IAASB has learned from its ISA Implementation Monitoring project in terms of where specific standards could be enhanced to drive improved audit quality. Therefore, enhancing the standards in these areas may also help improve auditor performance and result in reduced levels of inspection findings.
12. Regulators and audit oversight bodies have also highlighted concerns related to the auditing of accounting estimates (including fair value measurements), including noting instances where auditors do not appear to have applied the necessary professional skepticism. These stakeholders are calling for more robust requirements in the ISAs to direct how the auditor is expected to obtain sufficient appropriate audit evidence in relation to accounting estimates, including more granularity relating to the evaluation of management's assumptions and consideration of indicators of management bias. The IAASB's project to revise ISA 540 will consider these issues.⁶
13. The IAASB also recognizes that broader environmental factors – referred to in the AQ Framework as “contextual factors” – have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality. As countries develop and, in particular as businesses grow in size and need to obtain finance from capital markets, the environment becomes more complex. Financial reporting is very important to decision-making and user expectations as to its reliability remain high. In response, law, regulation, financial reporting requirements and corporate governance processes continue to develop and adapt. The evolving business environment and increasing complexity poses challenges for preparers and those charged with governance (e.g., audit committee members) who are responsible for preparing or overseeing the preparation of high-quality financial statements, including related disclosures. Concomitant challenges also arise for auditors.

⁶ The IAASB has commenced work to consider the potential need for strengthened requirements and enhanced guidance for auditors as it relates to auditing accounting estimates in light of developments in financial reporting standards, and actions necessary to address issues specific to audits of financial institutions.

14. As the environment in which financial reporting and auditing takes place continues to evolve, it is necessary for the IAASB to be mindful of these contextual factors in its standard-setting activities, to ensure that the ISAs are, and remain, “fit for purpose.” Of particular relevance to the IAASB are the following contextual factors and related developments:
- *Business practices and commercial law* – Law or regulation may create tax or other incentives based on how and where entities are domiciled, which may influence how entities are structured. Entities are also increasingly using shared service centers to improve effectiveness and enhance the efficiencies of their operations.
 - *Laws or regulations relating to financial reporting and the applicable financial reporting framework* – Financial reporting frameworks are increasingly requiring significant management judgment and relying more on forward-looking information as the basis for recognition or measurement or as information to be disclosed in the financial statements.
 - *Information systems* – Businesses are becoming dependent on complex systems and the sophisticated underlying technologies, with an increasing focus on “big data.” Audits are also increasingly being conducted using advanced technologies (including the evolving use of audit data analytics).
 - *Corporate governance* – In recognition of their important role in enhancing audit quality, audit committees are being called on to become stronger and more active;⁷ not only with regard to their interactions with auditors, but also as it relates to their responsibilities for oversight of the financial reporting process
 - *Audit regulation* – Increasingly, law or regulation provide that inspections of audits of listed entities be undertaken by independent audit regulatory bodies. Audit inspections provide an important mechanism for evaluating auditors’ compliance with auditing standards and, depending on the mandate, other aspects of audit quality. Actions taken by firms to address weaknesses identified through inspections have the objective of improving audit quality.
 - *Attracting talent* – Auditing is a demanding intellectual activity requiring the application of good judgment, an inquiring mind, and considerable business, financial reporting and auditing knowledge. The changing business and regulatory environment has affected how audits are carried out, in particular audits of multi-national entities (which are often “group audits”). As a result, firms are contemplating their own structures and how best to organize engagement teams and conduct audits, with a view towards involving appropriately skilled and competent people to perform high-quality audits at a reasonable cost. Members of an audit engagement team may no longer all be located in the same place (which, historically, has been the traditional audit model); rather, members may now be in different jurisdictions or time zones. The IAASB refers to these evolving models as ADMs, a term that is intended to encompass terms such as “firm shared service centers,” “centers of excellence,” “on-shoring,” “offshoring,” or “outsourcing.”

⁷ For example, the Organisation for Economic Co-operation and Development (OECD) revised its the Principles of Corporate Governance, issued in 2015 and endorsed by the G20 Finance Ministers. These principles serve as the basis for the guidelines on corporate governance of banks issued by the Basel Committee on Banking Supervision. Audit committees may also be required to report externally on how they discharged their responsibilities (e.g., in the UK).

15. Some firms have also highlighted the need, in some cases, for the development of firm guidance to bridge perceived gaps or difficulties in applying the ISAs and ISQC 1 to circumstances not specifically addressed in the standards. Concerns were (and continue to be) expressed by the SMP community that more is needed to better support them in effectively applying the ISAs and ISQC 1.
16. The profile of tomorrow's auditor is that of a critical challenger, supported by a regime focused on public interest and quality management. In order to achieve the IAASB's strategic objective related to the global use of ISAs and in order to continue to deliver against the public's expectations of audit quality and of the role of auditors, the IAASB believes that the ISAs and ISQC 1 need to better address the matters set out in paragraph 3 above, in particular increasing complexity and use of new technologies in both the business and audit environment. The following sections relating to Professional Skepticism, Quality Control and Group Audits set out the IAASB's thinking about how this might be approached.

Questions

G1. Paragraph 3 of this ITC describes what the IAASB believes are the most relevant public interest issues the Board should address in the context of its projects on professional skepticism, quality control and group audits. In the context of these three key projects:

- (a) Do you believe these public interest issues are relevant and meaningful to the Board's work on those topics? If not, why not?
- (b) Are there other public interest issues that would be relevant to those topics? If so, please describe them and how, in your view, they relate to the specific issues the IAASB plans to address in relation to the topics.

In your view, are there actions needed by parties other than the IAASB to address the public interest issues the IAASB believes are most relevant to enhancing audit quality in relation to these topics? If yes, what are they and which stakeholders have a role to play in this?

G2. Enhancing audit quality will continue to be a theme as the IAASB develops its *Work Plan for 2017–2018*. To assist the IAASB in this regard, are there other actions not specific to the topics of quality control, group audits or professional skepticism that you believe need to be undertaken by the IAASB to address the threats to audit quality more broadly? If yes, what are they and how should they be prioritized?

Strengthening Professional Skepticism in the Audit

17. In planning and performing audits, a mindset that includes professional skepticism is necessary in order for auditors to remain cognizant of circumstances that may cause the financial statements to be

Professional Skepticism

An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.⁸

materially misstated. Accordingly, professional skepticism is necessary to the critical assessment of audit evidence. Unless auditors are prepared to challenge management's assertions (including when management has used an expert to assist in preparing financial statements), they will not be able to conclude, with confidence, whether an entity's financial statements are fairly presented in accordance with the applicable financial reporting framework.

18. Also essential to the auditor's decision making and the overall conduct of an audit is the concept of professional judgment. Professional judgment (which is required by the ISAs to plan and perform audits) is the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.⁹ The concepts of professional skepticism and professional judgment are closely related, and together are key inputs to audit quality. Professional skepticism facilitates the appropriate exercise of professional judgment by the auditor. Similarly, the exercise of professional skepticism is subject to professional judgment.

19. Like other concepts fundamental to auditing, the topic of professional skepticism is multi-faceted, and is impacted, or is perceived to be impacted by, other related concepts such as:

- Independence of mind and integrity, with linkages to firm culture, governance and incentives.
- Objectivity, as it addresses cognitive biases.
- Due care, for example where the auditor considers only corroborative evidence compared to also considering the effects of conflicting evidence.
- Training and education, skills and experience, which are necessary to cultivate an individual's ability to appropriately exercise professional skepticism.

20. While it is difficult for a single definition to fully capture the concept of professional skepticism, as noted above, the ISAs describe important elements that help in the understanding of what professional skepticism is intended to mean (see [February 2012 staff publication](#)).¹⁰ Professional skepticism is also addressed in the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code)¹¹ and the International Accounting Education Standards Board (IAESB) standards.¹²

⁸ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)

⁹ ISA 200, paragraph 13(k)

¹⁰ ISA 200, paragraph 13(l)

¹¹ The IESBA Code explicitly mentions the term professional skepticism in a number of places including in the definition of "independence" – both independence of mind, and independence in appearance. There is also a perceived connection between professional skepticism and the fundamental principle of objectivity and integrity, though there is not an explicit reference.

¹² International Education Standards (IES) 2, *Initial Professional Development-Technical Competence (Revised)*; IES 3, *Initial Professional Development-Professional Skills (Revised)*; IES 4, *Initial Professional Development-Professional Values, Ethics,*

21. Although the ISAs explicitly recognize the fundamental importance of professional skepticism, regulators and audit oversight bodies have highlighted instances where they believe auditors have not clearly demonstrated appropriate professional skepticism in the planning and performance of their audit procedures. Some have also suggested that more robust documentation requirements, in particular related to the bases for the auditor's professional judgments and how appropriate professional skepticism has been applied, are needed in the ISAs.¹³ The IAASB therefore believes that it is in the public interest to explore these matters further and challenge what more can be done to re-emphasize to both auditors and others the important role that professional skepticism plays in audits of financial statements.

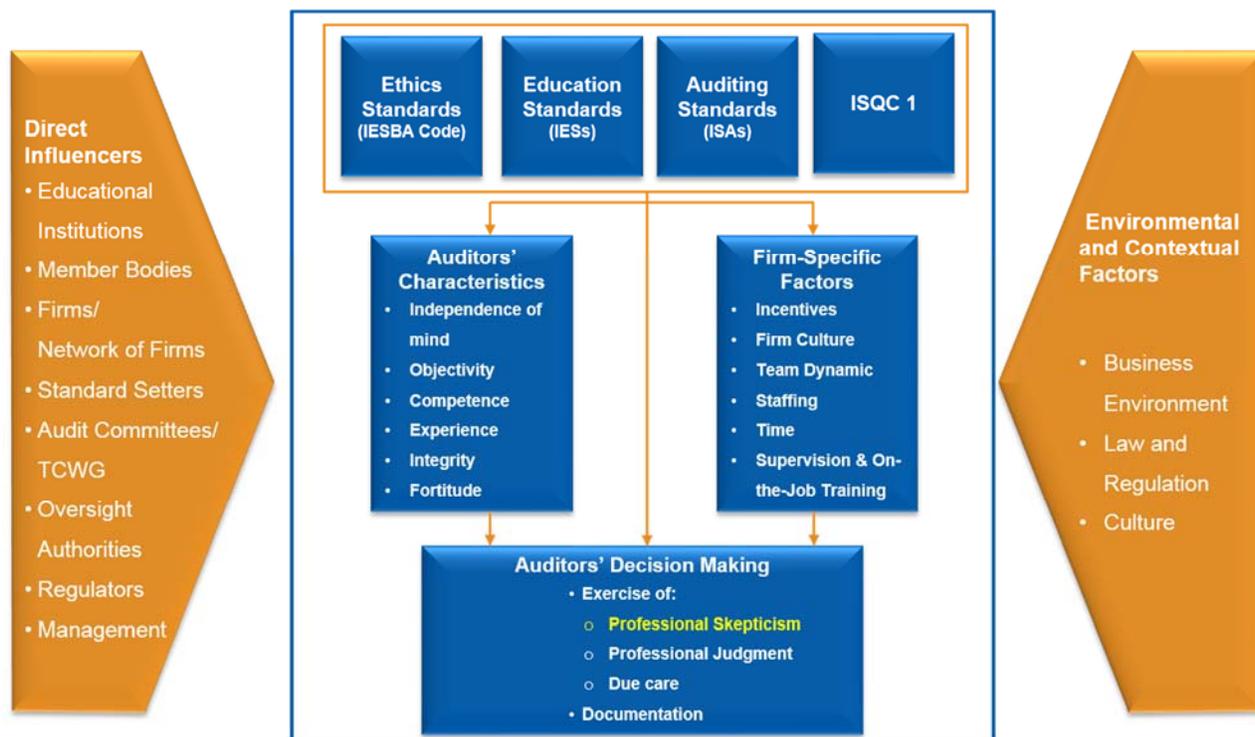
Establishment of a Joint Working Group

22. The topic of professional skepticism is addressed in the standards that are issued by the IAASB, IESBA, and IAESB (collectively referred to as the standard-setting Boards or SSBs). A Joint Working Group comprising of representatives from each SSB has therefore been formed to explore on a broad level, what actions may be appropriate to respond to concerns that have been raised about the application of professional skepticism in audits. The objective of this Joint Working Group is to identify the conceptual issues related to professional skepticism across the ISAs, IESs and the IESBA Code, including where further alignment is warranted or where gaps may exist, and make observations or recommendations for further actions to be considered. It is envisaged that the discussions of the Joint Working Group, in conjunction with the interactions of Working Group members with their respective Boards, will enable the SSBs to consider what standard-setting activities may be appropriate and what other potential actions might be necessary to further enhance the application of professional skepticism by auditors.
23. As part of its preliminary work, the Joint Working Group has developed a diagram (see paragraph 24) to illustrate some of its initial views about the potential interactions and contextual factors in relation to professional skepticism. This diagram focuses on those stakeholders with direct influence on the auditor's application of professional skepticism.
24. The diagrams also illustrates that the suite of international standards (the ISAs, IESs and the IESBA Code) is collectively relevant to the exercise of professional skepticism in audits. Each set of standards addresses a specific area of focus. For example, the IESBA Code primarily deals with matters that are relevant to auditor's characteristics (e.g., independence of mind and objectivity) and auditor's decision-making (e.g. due care); the IESs focus on auditors' characteristics (e.g., competence and experience) and ISQC 1 focuses on firm-specific factors, including leadership qualities (e.g., the "tone at the top") within a firm; while the ISAs address matters that are relevant to the auditor's decision-making (e.g., professional judgment and professional skepticism).

and Attitudes (Revised); and IES 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)* provide guidance on the expected outcomes that assist professional accountants and engagement partners to demonstrate effective "professional skepticism" and "professional judgment." Both IES 8 and IES 4 emphasize that effective development of professional skepticism needs to include learning methods such as mentoring, reflective activity, and practical experience within the context of a work environment.

¹³ It has also been suggested that consideration may be given to developing criteria that can be used to determine the quality, and effectiveness of professional skepticism that is applied by an auditor (e.g., a professional judgment framework) and that such criteria and framework should be established either at an international level or within the firm.

Professional Skepticism: Interactions and Contextual Factors



25. Preliminary discussions among members of the Joint Working Group indicate that standard-setting activities alone will not be sufficient to address issues relating to professional skepticism. Together with firms who are responsible for establishing a culture that fosters professional skepticism, others (including those charged with governance, regulators, audit oversight authorities, prudential supervisors and member bodies) are well positioned to challenge and question the auditor’s exercise of professional skepticism in audits. Also, in light of the interactions contemplated in the AQ Framework (see AQ Framework at paragraph 9), the IAASB and IAASB Consultative Advisory Group (CAG) believe that others also have an important role to play in enhancing auditor professional skepticism.

26. As a basis for developing its recommendations and observations, the Joint Working Group plans to start begin its exploration of the topic of professional skepticism by reviewing the extant suite of international standards issued by each of the SSBs with a focus on understanding the following:
- What is meant by the term professional skepticism? Are the current description, the requirements and expectations clear to auditors and others? Are the linkages that exist between the term professional skepticism and other concepts such as professional judgment, due care, integrity, independence of mind, objectivity, and competence (see paragraph 17–19) sufficiently clear and well understood?
 - What are the skills and competencies required for applying professional skepticism? What are the impediments affecting the consistent application of professional skepticism?
 - How can it be determined that the exercise of professional skepticism has been appropriate given the circumstances?

27. The Joint Working Group plans to conduct outreach and seek input from respondents through the course of its work. Responses to this consultation on the topic of professional skepticism are expected to be useful in informing the Joint Working Group's work as it develops its observations and recommendations. Simultaneously, the IAASB welcomes the opportunity to obtain views from respondents about the changes that could be made to its standards to more directly encourage the application of professional skepticism, in the context of quality control and group audits.
28. For example, with respect to quality control, because professional skepticism within the engagement team is influenced both by the actions of the firm's leadership and the engagement partner, and by the culture and business environment of the firm, changes being considered in relation to ISA 220 and ISQC 1 may positively affect the application of professional skepticism in audits (see paragraphs 35–170). At the engagement level, ISA 220 requires the engagement partner to take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to members of the engagement team are intended to emphasize that quality is essential in performing audit engagements and promote the engagement team's ability to raise concerns without fear of reprisals and in issuing auditor's reports that are appropriate in the circumstances.
29. With respect to group audits various concerns have been raised relating to the judgments made by the group engagement partner and group engagement team in relation to various aspects of the group audit engagement. As revisions to the standards are contemplated, it will be important to consider what steps can be taken to better encourage appropriate exercise of professional skepticism with respect to these judgments (see paragraphs 171–279).

Relevance to IAASB's Other Projects

30. The topic of professional skepticism is relevant to all of the IAASB's individual projects, including those not covered by this consultation. For example, the IAASB has acknowledged that its work in relation to ISA 540 provides an opportunity to emphasize the importance of professional skepticism and professional judgment, as accounting estimates that have been identified as having high estimation uncertainty generally involve significant management judgment and the possibility for unintentional or intentional management bias. In this regard, consideration could be given as to how the requirements are drafted, focusing on a more questioning mindset rather than one of corroboration.
31. The Board's other planned projects (e.g., the project to address issues identified relating to ISA 315 (Revised)¹⁴), may also identify areas where further emphasis of professional skepticism may be useful.

IAESB and IESBA Initiatives

32. The IAESB's recent consultation [recently approved, to be released by early December 2015] on its future strategy acknowledges the relevance of the topic of professional skepticism and poses a question to stakeholders about what actions may be specifically necessary by the IAESB to improve the professional competencies of auditors related to the exercise of professional skepticism.
33. The IESBA is actively contributing to the activities of the Joint Working Group with a view to

¹⁴ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

determining whether there are areas within the IESBA Code where there would be benefit in elaborating on, emphasizing or clarifying ethical considerations relating to professional skepticism in ways that would support and complement the discussion of professional skepticism in the ISAs and the IESs. The IESBA will be kept apprised of the relevant issues by its representatives on the Joint Working Group as this initiative progresses.

34. Input from the IAESB's consultation, further understanding of relevant academic research, and feedback to this consultation will assist the Joint Working Group in developing its observations and recommendations to the SSBs, including the IAASB, about what is needed with respect to professional skepticism in the public interest.

Questions

PS1. The IAASB is exploring what actions it could take to strengthen the application of professional skepticism in audits.

- (a) What are your views about how the concept of professional skepticism is described in the ISAs and addressed in the IESs and the IESBA Code (see paragraph 17 and footnote 12 above)?
 - (i) What are your views about the interactions and contextual factors depicted in the diagram at paragraph 24 above?
 - (ii) Are there other areas beyond those described in paragraph 26 that the Joint Working Group should explore?
 - (iii) What do you think should be done in the context of the IAASB's key projects (i.e., quality control and group audits) to further emphasize application of professional skepticism by auditors)?
 - (iv) What are your views about how the IAASB as part of its other projects and activities (see paragraphs 30–31), could further challenge auditors to exercise professional skepticism in conducting audits?
- (b) In your view, what action(s) would be most meaningful for the IAASB to undertake in light of its mandate and why?
- (c) How may auditors better demonstrate the exercise of professional skepticism in the audit documentation?
- (d) What other actions may be necessary to strengthen the application of professional skepticism and who, in your view, is best placed to carry out these actions (e.g., other standard setters, firms and member bodies, etc.)?

Strengthening the Standards Addressing Quality Control

The feedback received by the IAASB in developing its *Work Plan for 2015–2016* indicated that there are issues and concerns in the following areas related to quality control:¹⁵

In relation to Engagement Quality Control Reviews (EQCR)—Concerns about the selection of engagement quality control reviewers (in particular, in light of previous inspection findings and competency to carry out such reviews), independence of the reviewer from the engagement team, the professional skepticism exercised by the reviewer; and the other matters relating to the objective, extent and timing, and documentation of the EQCR.

In relation to the IAASB’s development of the Framework for Audit Quality and other outreach—Consideration of whether aspects of the Framework may need to be addressed either within the requirements or guidance in ISQC 1 and ISA 220 or, as appropriate, by the International Ethics Standards Board for Accountants’ *Code of Ethics for Professional Accountants* (IESBA Code),¹⁶ for example:

- Engagement performance (matters relating to consultations, technical reviews of financial statements, engagement acceptance, appointment of engagement team members, independence and ethics, changing resource models (e.g., audit firm use of shared service centers);
- Human resources (technical competence / capabilities and expertise of the engagement team, including the engagement partner, recruitment and training, remuneration based on audit quality);
- Internal monitoring reviews, including scope and extent;
- Using the work of a specialist and auditor’s expert, and the differences between the two;
- Clarification of definitions, such as “professionals”, and further guidance on the applicability to public sector audits;
- Governance structures of firms and networks.

In relation to remediation—Whether there is a need within ISQC 1, or elsewhere in the ISAs, for the IAASB to acknowledge the importance of a firm’s system of quality control addressing root cause analysis of significant audit deficiencies that have been identified by external inspections. Regulators suggested that greater consistency in practice by firms to respond to inspection findings in respect of individual audits may be seen as a means to improving audit quality.

In relation to proportionality of ISQC 1 for small and medium practices (SMPs) and applicability to reviews, other assurance and related services engagements—Concerns have been raised that ISQC 1 cannot be proportionately applied by SMPs performing audits, and SMPs and others have also suggested that it could be made more clear as to how ISQC 1 can be applied to reviews, other assurance, and related services engagements.

¹⁵ Input included the [findings](#) from the IAASB’s ISA Implementation Monitoring project, a stakeholder survey on work plan priorities, consultation on the proposed Work Plan for 2015–2016, and input from outreach with key stakeholders.

¹⁶ The IAASB will continue to coordinate and collaborate with the IESBA on topics of mutual interest.

The matters above present a summary of the initial input to the project on quality control as presented in the [IAASB's Work Plan for 2015–2016](#). However, in exploring these matters further, and based on the IAASB's deliberations and input from its CAG and from outreach activities, the IAASB's understanding of some of the issues has evolved, and in some cases the issues have been refined or expanded. The description of the matters in the discussion that follows reflects these refinements and expansions.

The IAASB believes that the issues set forth below represent those matters where priority attention may be needed to take action to respond to public interest calls to enhance audit quality in relation to quality control. In considering changes to ISQC 1 and ISA 220, the IAASB is also exploring revising ISQC 1 to incorporate the use of a Quality Management Approach (QMA) (described in paragraphs X-X) which would involve a broader approach to managing quality than the current approach to quality control in extant ISQC 1.

The IAASB is particularly interested in further understanding stakeholders' views about the issues affecting quality control and the possible actions that may be taken (including input on the IAASB's initial views about those actions). In particular, the IAASB is interested in understanding whether the issues have been overcome (e.g., because firms have developed internal guidance to address certain aspects of the issues) or whether practical challenges continue to be experienced and whether these are as described in the paragraphs that follow. The IAASB is also interested in hearing about actions related to quality control that may help emphasize professional skepticism or how the IAASB's possible actions might be enhanced to better emphasize and support the appropriate application of professional skepticism. In describing the issues and possible actions, the IAASB has not explicitly addressed changes to the definitions of terms that are already defined in the ISAs and ISQC 1. However, in making changes to ISQC 1 and the ISAs it may be necessary to also revisit the relevant definitions to determine whether changes are needed.

The issues relating to quality control for an audit that are discussed below are organized as follows:

- A new quality management approach (See paragraphs 35–51)

Crossover Issues / Issues relevant to More than One Project

- Engagement partner roles and responsibilities (See paragraphs 53–70)
- Others involved in the audit (See paragraphs 71–88)
- Quality control policies and procedures as part of operating through a network of firms (See paragraphs 91–100)
- Exploring the potential effects that firm's changing business models and structures have on audit quality (See paragraphs 101–107)

Quality Control Specific Matters

- Governance of the firms, including leadership responsibilities for quality (See paragraphs 109–119)
- Engagement quality control reviews and engagement quality control reviewers (See paragraphs 120–130)

- Monitoring and remediation (See paragraphs 131–141)
- Engagement partner performance and rewards systems (See paragraphs 142–152)
- Human resources (See paragraphs 153–158)
- Engagement partner competencies (See paragraphs 159–167)
- Transparency Reporting (See paragraphs 168–170)

A NEW QUALITY MANAGEMENT APPROACH

Post-Implementation Feedback on ISQC 1

35. ISQC 1 provides the foundation for the approach to quality for firms of all sizes, and addresses requirements for a firm's system of quality control for audits and reviews of financial statements, and other assurance and related services engagements. An effective system of quality control supports consistent quality in all of the services a firm provides and is one of the essential components of how a firm manages itself. ISQC 1 requires a firm to develop policies and procedures that address key elements of a system of quality control. These elements include leadership responsibilities for quality within the firm, relevant ethical requirements, acceptance and continuance of client relationships and specific engagements, human resources, engagement performance and monitoring. ISA 220¹⁷ complements ISQC 1 by addressing quality at the individual audit engagement level. ISA 220 is premised on the basis that the firm is subject to ISQC 1 or to national requirements that are at least as demanding as ISQC 1.
36. As the environment in which firms operate evolves and the focus on quality intensifies, questions have arisen about whether ISQC 1 could be made more robust overall, as well as about specific matters that could be more explicitly or better addressed. The IAASB's ISA Implementation Monitoring project identified issues and concerns related to applying ISQC 1, and regulators and audit oversight bodies have identified this standard as requiring further consideration, in particular in relation to:
- (a) More direct responsibility of firm leadership, and accountability of appropriate personnel within firm leadership, for quality, the need for a strong "tone at the top" by firm leadership and a focus on continually enhancing quality;
 - (b) Understanding causal factors of, and related remedial actions implemented to respond to, findings from both external and internal inspections;
 - (c) Monitoring the effectiveness of remedial actions and, where necessary, making adjustments to those actions when it becomes clear that they are not achieving the desired results; and
 - (d) Establishing greater linkages between policies and procedures addressing human resource matters (e.g., recruitment, retention, training and remuneration) and accountability for quality.
37. The IAASB also acknowledges that ISQC 1 is perceived by some stakeholders as taking or appearing to require a "one size fits all" approach to quality control, i.e., with little regard or guidance to acknowledge how to deal with differences in the size and nature of the firm or the services the firm provides.

¹⁷ ISA 220, *Quality Control for an Audit of Financial Statements*

Introduction to the Quality Management Approach

38. The IAASB notes the competing challenges encountered with ISQC 1, including its application by firms of all sizes. In reflecting on the most appropriate way to revise ISQC 1 in response to the feedback received, the IAASB has considered and supports an approach that would involve a broader revision and restructure of ISQC 1 (i.e., as opposed to a targeted revision of its existing individual requirements and supporting application material).
39. Such an approach would require firm leaders to take responsibility for a more proactive and innovative approach to managing quality and establishing the related supporting systems. Such an approach would involve identifying relevant risks to quality and designing appropriate policies and procedures to address those risks, and is referred to in this ITC as a “QMA”. Firms have many different policies and procedures in place today to meet the objectives of ISQC 1, and which vary depending on the individual circumstances of the firm. A QMA would embed in ISQC 1, the importance of the interdependence of a firm’s policies and procedures that support consistent quality in all of the services a firm provides—a principle some firms may have already incorporated into their systems of quality control. In making broader revisions to ISQC 1 to incorporate a QMA, the IAASB would concurrently address the specific issues and concerns with the current quality control requirements, potentially strengthening the requirements and enhancing the application guidance in the standard.
40. The IAASB also believes that such a redesign of its standards provides an opportunity to further demonstrate how ISQC 1 is scalable – in particular for SMPs who may not conduct audits of financial statements of listed entities (or audits at all). Specifically, the IAASB believes that requiring a QMA would support firms in designing and implementing effective quality management systems that:
- (a) Take account of the size and nature of the firm, the services the firm provides and the nature of the entities to whom those services are provided, and
 - (b) Are sufficiently flexible to take account of ongoing changes in the environment in which the firm operates, including changes in the legal and regulatory environment in the applicable jurisdiction(s) in which the firm operates.

Revising ISQC 1 in this manner may lead to changes to ISA 220. For example, there may be a need in ISA 220 to more explicitly address requirements for proactive management by the engagement partner of quality risks at the engagement level. Similarly, as revisions to ISA 600 are contemplated, consideration will be given to the implications for group audits of a QMA at the firm level. For example, the existence of a firm-level QMA may impact the engagement level considerations about acceptance and continuance of group audit engagements.

41. This consultation provides an opportunity for the IAASB to obtain views and further input to assist in moving forward with a revision of ISQC 1 to incorporate a QMA. Using this approach in ISQC 1 would not only enable the IAASB to improve the requirements in the standard with respect to particular elements of a firm’s quality management system, but would also enable a broader look at a firm’s approach to quality more generally. Key aspects of the IAASB’s preliminary thinking about how a QMA would be incorporated into ISQC 1 are set out below.

Incorporating a QMA into ISQC 1

42. A QMA would increase the focus in ISQC 1 on the importance of and need for effective firm leadership as a foundation to the ability of the firm to achieve quality at all levels. Specific requirements may address the need for:
- (a) Creating the appropriate culture and tone within the firm, including a focus on leadership accountability for quality and the important role leaders in the firm have in this regard; and
 - (b) Setting the basis for how the risk of not meeting the firm’s quality objectives (quality risk) is viewed and addressed by the firm and its people, which includes consideration of integrity and ethical values and the environment in which the firm operates.

Table 1. Some of the differences between the approach taken in extant ISQC 1 and how ISQC 1 might be changed under a QMA are illustrated in the table below.

ISQC 1		
Key Areas to Be Explored	Extant	QMA
Risk(s) of not achieving quality objectives	Emphasis on standardized assumptions regarding the risks of a firm not meeting its quality objectives and a standardized approach to a firm’s system of quality control that may not always fit with a firm’s particular circumstances or sufficiently facilitate adapting to an evolving environment. As noted in the October 2012 Staff Q&A publication , ISQC 1 does provide guidance regarding the appropriate application of ISQC 1 considering the circumstances of the firm. For example, paragraph 14 of ISQC 1 requires firms to comply with each requirement in ISQC 1 unless, in the circumstances of the firm, the requirement is not relevant to the services provided. Paragraph 15 of ISQC 1 notes circumstances vary widely and all such circumstances cannot be anticipated, therefore a firm may need to establish policies and procedures in addition to those required by ISQC 1 to meet the stated objective.	ISQC 1 would retain essential requirements, and would describe the actions to address the requirements premised on requiring the firm to design and implement appropriate responses to quality risks. The firm’s risk identification process would take into account the evolving environment in which the firm operates, such as financial reporting framework developments and the firm’s ADMs.
Monitoring quality from all sources	ISQC 1 includes requirements related to monitoring, but with a focus on results from internal inspections and peer reviews.	A QMA would promote the need for consideration of all feedback on quality, including from inspections (internal and external) and peer reviews, but also from other kinds of monitoring that a

ISQC 1		
Key Areas to Be Explored	Extant	QMA
		firm may perform such as pre-issuance and post-issuance reviews. A QMA would more clearly address that monitoring of the effectiveness of the remedial actions to address identified deficiencies is critical to focus on continually enhancing quality, placing greater emphasis on achieving a quality outcome prior to the issuance of the deliverable.
Conditional requirements	Few conditional requirements (i.e., requirements that only apply in particular circumstances).	Increased use of conditional requirements resulting from enhanced focus on a firm's individual circumstances in setting quality objectives, assessing related quality risks and designing effective responses. For example, additional requirements may be identified as necessary for firms that audit listed entities or other entities of particular public interest, to acknowledge the effects of law or regulation.
Scalability	Individual requirements do not contain detailed explanatory material that could assist firms of all sizes and with all different types of practices in designing appropriate policies and procedures in light of the relevant facts and circumstances.	Scalability embedded in a QMA (e.g., factors to consider could or would be embedded in specific requirements to support achievement of quality objectives and firms would be expected to apply them in determining nature and extent of policies and procedures necessary to address the requirements). This approach would explicitly acknowledge that responsive policies and procedures would likely vary depending on the nature and assessment of the related risks of the firm not achieving its quality objectives, benefiting firms of all sizes.
Audit and non-audit context	ISQC 1 viewed as largely applicable for what is necessary to support a firm's performance of audit engagements, with less attention being given to expectations or requirements for other types of engagements.	The broader approach of a QMA would enable a firm to consider its quality objectives and the related risks not only in the context of audit engagements, but also for other types of engagements (e.g., reviews and other assurance engagements, compilations, and agreed-upon procedures).

Interaction of the QMA with the Firm's Culture and Strategy

43. A QMA may facilitate more effective integration of a firm's quality management system into other aspects of its management structures and business processes, thereby further enhancing a culture of focusing on quality throughout the firm, and accountability for quality by its leaders. Integration of the firm's quality management system with corporate governance systems and risk and compliance management systems may lead to proactive processes related to understanding and responding to internal and external inspection findings.
44. The IAASB believes that a firm's culture and strategy are at the core of a QMA, and foundational to its effectiveness. The firm's overall strategy would be required to incorporate its quality objectives, which, consistent with extant ISQC 1, would be to establish and maintain a quality management system that provides the firm with reasonable assurance that:
- (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
 - (b) Reports issued by the firm or engagement partners are appropriate in the circumstances.¹⁸
45. As described in the AQ Framework, a firm's culture has an important influence on the values, ethics and attitudes of partners and other members of the engagement team because the environment in which the engagement team works can materially affect the mindset of partners and staff, and consequently the way they discharge their responsibilities. While the audit is designed to protect the public interest, audit firms are often commercial entities. Each firm's culture will be an important factor in determining how its partners and staff are successful in serving the public interest as they perform audits and at the same time achieve the firm's commercial goals. The QMA would make it clear that firm leadership, as part of the firm's governance structure, is responsible for establishing the firm's overall culture and strategy, and thereby accountable overall for quality.
46. Effective operation of the quality management system, including embedding quality in all of the firm's activities, requires a transparent and clear definition, and communication, of roles and responsibilities, as well as sufficient and appropriate resources in terms of human capital, policies, methodologies, tools and other guidance.

Elements of a QMA

47. Revising ISQC 1 to focus on a QMA may include using an approach that is similar to, or aligned with, principles in existing risk management and governance frameworks.¹⁹ Key aspects of the IAASB's preliminary thinking about how ISQC 1 would incorporate a QMA include:
- Incorporating the relevant activities in support of the continually evolving process of a QMA, the elements of which are set out in the diagram below.
 - Retaining the existing objectives and fundamental requirements in ISQC 1, although the way that the standard is structured would likely be revisited.

¹⁸ These quality objectives align with the objectives of ISQC 1, as described in paragraph 11 of the standard.

¹⁹ For example, the OECD's Principles of Corporate Governance; and The Enterprise Risk Management—Integrated Framework (2004) issued by the *Committee of Sponsoring Organizations* of the Treadway Commission (COSO ERM Framework). The COSO ERM Framework is in the process of being updated to make it more relevant in the increasingly complex business environment. COSO expects to publish an exposure draft for public comment in the first quarter of 2016.



Table 2. Relevant Activities in Support of Elements of the QMA

<i>Elements of the Quality Management Approach</i>	<i>Relevant Activities</i>
Establish quality objectives	The firm's quality objectives build upon the core principles of its strategy and culture. Paragraph 48 describes factors a firm would consider in establishing relevant and appropriate quality objectives. Direct responsibility of firm leadership, and accountability of appropriate personnel within firm leadership, for quality.
Quality risk assessment	A structured approach to identifying those events and conditions that may have a significant effect on the firm's ability to achieve the quality objectives, including the effect of the interactions with and the role of others in contributing to audit quality as described in the AQ Framework, is foundational to an effective QMA. Identified quality risks are assessed for probability of occurrence and likelihood and magnitude of potential consequences at the firm and by engagement type. This risk assessment process should be sufficiently detailed to serve as a basis for designing and responding to quality risks and implementing quality control activities.
Design and implement responses to quality risks	The firm determines appropriate responses to identified quality risks, designed to avoid, reduce, share, transfer or accept risks, providing reasonable assurance that the policies and procedures address the risk of the firm not being able to achieve its quality objectives. Some risks may be

<i>Elements of the Quality Management Approach</i>	<i>Relevant Activities</i>
	considered together, while other risks may require more than one response or layered responses. The quality objectives serve as a framework for these decisions, which may result in the development and implementation of policies and procedures. In an audit context, these policies and procedures would help firms increase the prospect of delivering a quality audit, where the financial statements being opined upon comply with the financial reporting framework or results in an auditor's report that communicates the auditor's disagreement or restricted ability to opine.
Implement quality control activities	The firm implements quality control responses and activities through the development of appropriate policies and procedures.
Inform, communicate and document	Identification, capture, and communication of relevant risk information in a format and time frame that enables individuals to carry out their responsibilities is an essential component of a QMA. Communication includes having appropriate communication resources (e.g., information systems infrastructure) to provide timely and relevant information to the firm's leadership regarding the operation of the firm's quality management system.
Quality monitoring	The design and operating effectiveness of the quality management system and related activities are monitored through both integrated and distinct monitoring activities, promoting the consideration by firm leadership of all feedback received on quality. These monitoring activities include external inspections and other reviews (such as peer reviews, internal inspections, pre-issuance and post-issuance reviews). The findings from these monitoring activities are considered by firm leadership and used to assess the effectiveness of the firm's quality management system as well as to determine whether remedial action is necessary. Monitoring activities might result in the identification of different risks or reassessment of previously identified risks, and could potentially signal a need for new or improved responses to address such risks or the need to revisit the quality objectives – thereby continually improving the effectiveness of the quality management system.

48. In defining and setting its quality objectives under a QMA, the firm would be required to consider various factors, which would include:

- The types of services the firm provides or anticipates it will provide in the future. The firm may, for example, consider:
 - Does or will the firm perform audits, reviews and compilations and other related services; all, only one or a combination of these?

- Does or will the firm perform such services for listed entities, other entities of particular public interest, non-listed entities (including small and medium-sized entities (SMEs) and micro-entities); all, only one or a combination of these? Are those services performed for entities in particular industries or jurisdictions?
 - Its relevant stakeholders (such as users, preparers, audit committees), the interactions of these stakeholders as described in the AQ Framework in contributing to audit quality, and what they expect in seeking to rely on reports issued by the firm.
49. The identification of risks that may affect the firm's ability to meet its quality objectives is also performed in the context of both the entities for which engagements are undertaken and the types of those engagements. These include external risk factors (such as the Contextual Factors noted in the AQ Framework) and internal risk factors, such as:
- Assessing qualifications, experience, skills and knowledge of the firm's work force;
 - The impact of the organization of the firm, including when the firms use ADMs to support their engagements;
 - The potential effect of staff turnover (i.e., reliance on certain staff and risk that if these staff left the firm, quality would be impacted); and
 - Resource availability to staff engagements, including cooperation and sharing of resources within the firm, and prioritization of work importance when certain individuals perform services for audits as well as other engagements.
50. It has also been observed that corporate governance challenges that came into focus in the wake of the financial crisis caused many companies to revisit their business practices and relevant activities to respond to current and emerging corporate governance risks, including in priority areas such as remuneration, risk management, board practices and the exercise of shareholder rights. Revising ISQC 1 to incorporate the use of a QMA may provide the opportunity for the IAASB to provide guidance as to how firms might, in appropriate circumstances, consider whether and how corporate governance principles²⁰ may be helpful or relevant in the context of identifying, assessing and responding to quality risks.
51. While stakeholders may have different views about the essential elements of a QMA and the relevant activities that have been described in this consultation, the IAASB believes that revising ISQC 1 to incorporate a QMA is responsive to stakeholders concerns, can be effectively implemented by firms of all sizes and, over time, will result in improved quality. The *Quality Control at the Engagement Level* and *The Firm's Role in Supporting Audit Quality* sections of this ITC describe in more detail specific areas for improvement in ISA 220 and ISQC 1, respectively.

Questions

QC 1. The IAASB is strongly considering a broader revision of ISQC 1 that would embed an approach to quality control that would require firm leaders taking responsibility for managing quality in a more proactive and innovative way (see paragraphs 35–51).

²⁰ For example, the OECD Principles of Corporate Governance.

- (a) Do you believe that the use of a QMA would assist in improving audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate such an approach?
- (b) If you support the use of a QMA by firms, are there other elements that you think should be explicitly included in such an approach in light of its objective (as outlined in paragraphs 47–51)?
- (c) In your view, how might this change to ISQC 1 impact other ISAs, including ISA 220?

CROSSOVER ISSUES / ISSUES RELEVANT TO MORE THAN ONE PROJECT

52. In addition to the discussion on professional skepticism in paragraphs 17-34, the following section sets out the issues that cross-over, or may be relevant to, more than one project covered by this consultation. These issues, and possible actions, are described together to obtain a more broader view about why actions that supplement each other in the separate projects are needed, for example, changes made in relation to aspects of ISQC 1 and ISA 220 may have implications for the changes that are being made in ISA 600.

Quality Control at the Engagement Level

Engagement Partner Roles and Responsibilities

ISA 220 sets out the responsibility of the engagement partner for:

- ❖ The direction, supervision and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements;
- ❖ Reviews being performed in accordance with the firm's policies and procedures;
- ❖ Being satisfied through a review of the audit documentation and discussion with the engagement team that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued; and
- ❖ The auditor's report being appropriate in the circumstances.

53. As the manner in which audits are conducted continues to evolve and adapt to the changing environment in which the entities under audit and the firms performing such audits operate, it is essential and in the public interest that the fundamental principles and expectations related to the roles and responsibilities of the engagement partner (or group engagement partner as applicable) are sufficiently clear, specific and well-articulated within the ISAs.

54. The engagement partner²¹ responsible for each individual audit engagement²² plays an essential role relative to audit quality and users' confidence, given that such partner is the individual responsible for the overall quality of the audit engagement to which that partner is assigned. Clarity about the role

²¹ The Engagement Partner is defined as "the partner or person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body".

²² As it relates to the public sector environment, the terms "client," "engagement," "engagement partner," and "firm" should, where relevant, be read as referring to their public sector equivalents as defined in International Standard of Supreme Audit Institutions (ISSAI) 40, *Quality Control for Supreme Audit Institutions*, Section 7.

and responsibilities of the engagement partner is therefore fundamental to the ongoing effective implementation of the principles-based ISAs and ISQC 1.

55. Before an engagement is accepted, or a decision made to continue an engagement, the engagement partner, is required to be satisfied that appropriate procedures regarding the acceptance and continuation of client relationships and audit engagements have been followed and that related conclusions reached are appropriate.²³ The engagement partner needs to be satisfied that:
- The preconditions for an audit, as set out in paragraph 6 of ISA 210, have been met, including that management has acknowledged its responsibility to provide the auditor with access to the information needed for the performance of the audit and unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
 - The engagement team collectively has the necessary competence and capabilities to properly perform the audit engagement,²⁴ and if not, that an appropriate auditor's expert will be used.²⁵
56. ISA 600 builds on the requirements of ISA 220, as well as other ISAs as relevant. Therefore these same requirements are relevant when the audit is an audit of group financial statements. Paragraph 4 of ISA 600, notes that, in accordance with ISA 220, the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities. It also notes that the group engagement partner is responsible for the direction, supervision and performance of the engagement. Paragraph 5 of ISA 600 notes that the engagement partner applies the requirements of ISA 220 regardless of whether the group engagement team or a component auditor performs work on the financial information of a component. It adds that ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial statements of components.
57. ISA 220 notes that the engagement partner is entitled to rely on the firm's system of quality control.²⁶ Accordingly, any changes to ISQC 1 to incorporate a QMA (as described in paragraphs 35-51) may better support the engagement partner in making risk-based decisions at the engagement level. For example, the decision to accept or continue an engagement could be better considered in the context of the firm's assessment of quality risks related to the client and the engagement, and considerations around for example, competence and capabilities of the members of the engagement team might be made in a more structured and informed manner.

ISSUES

58. Questions and concerns from regulators and audit oversight bodies, and practical challenges by practitioners, have arisen relating to how engagement partners, in certain situations, are taking overall responsibility for the performance of audits and demonstrating appropriate direction and supervision throughout.
59. Understanding what appropriate direction and supervision of an engagement involves and how to take responsibility for its performance and for appropriate reviews (and therefore what is necessary to

²³ ISA 220, paragraph 12

²⁴ ISA 220, paragraph 14

²⁵ ISA 620, *Using the Work of an Auditor's Expert*, sets out the requirements and application material for using an auditor's expert.

²⁶ ISA 220, paragraph 4

achieve compliance with the requirements of ISA 220) depends on the circumstances, including the size and complexity of the engagement. It has been noted that determining when and how the engagement partner should be involved and the specific aspects of that involvement, including having sufficient time and appropriate resources available, can be particularly challenging in some situations.

60. Feedback from stakeholders and IAASB discussions have identified some types or characteristics of engagements where it may be challenging for the engagement partner to demonstrate appropriate direction and supervision and take responsibility for the performance of the engagement and for appropriate reviews, including:
- An audit that involves delivery models that are different to the traditional engagement team structures (see further discussion about ADMs in paragraphs 101–107 of this ITC).
 - When other auditors are involved in an engagement that is not a group audit (i.e., the audit is not one of group financial statements and the other auditors are not component auditors as defined by ISA 600). Reference is made in paragraph 2 of ISA 600 to the ability to adapt ISA 600 to these situations, but it has been observed that the lack of more specific requirements or guidance proves challenging in practice (see further discussion on involvement of other auditors in paragraphs 80 and 84).
 - An audit in which the engagement partner is not located where the majority of the audit work is performed, and other auditors are involved in the audit (regardless of whether the audit is a group audit and whether these other auditors meet the definition of component auditors).
 - Specific to group audits, where group structures include non-controlled entities or shared service centers (SSC), or where there are issues in obtaining the necessary access to components (either management of the component or the financial information of the components) (access issues and possible actions to address these are further discussed in paragraphs 181-194, SSC issues and possible actions to address them are discussed in paragraphs 218(d) and 242).
61. The IAASB has already recognized that challenges arise in circumstances where the engagement partner is not located where the majority of the audit work is performed, and other auditors are involved in the audit. As noted in the August 2015 Staff Audit Practice Alert, [Responsibilities of the Engagement Partner in Circumstances When the Engagement Partner Is Not Located Where the Majority of the Audit Work is Performed](#), these issues arise in part because the nature of these and other multi-location audits make it more challenging for the engagement partner to discharge the required responsibilities for direction, supervision and review of the audit. It may also not be clear as to whether and how ISA 600 applies in some circumstances, i.e., in addition to the requirements of ISA 220 and other ISAs.²⁷
62. Other specific issues related to appropriate direction, supervision and review of the audit engagement by the engagement partner include:
- That ISA 220 also does not explicitly:
 - Address the need for the engagement partner to be satisfied that sufficient time and resources are available to the engagement team such that it will be possible to perform the necessary work to obtain sufficient appropriate audit evidence before the date of the auditor's report.

²⁷ ISA 600, paragraph 2

- Include discussion on how the requirement to take responsibility for the direction of the audit engagement is to be applied or what constitutes “active involvement” in an engagement. Although not part of the ISAs, the AQ Framework identifies active involvement of the engagement partner in the risk assessment, planning, supervision and review of the work performed as a key attribute to audit quality.
 - That ISA 220 is primarily focused on matters related to the planning of an audit engagement. Notwithstanding that ISA 220 provides some guidance on what direction of the engagement team involves,²⁸ there is not much detailed attention to responsibilities of the engagement partner as the audit progresses and is completed.
 - Concerns with the consistent application of acceptance and continuance requirements in ISQC 1²⁹ and ISA 220,³⁰ particularly related to the extent of consideration of the relevant ethical requirements for auditors that exist in the jurisdiction(s) the entity is located and whether the engagement partner has considered all relevant information prior to accepting or deciding to continue with the engagement.
 - The structure of the ISAs, in that the responsibilities of the engagement partner are located throughout the ISAs. Although the majority of the responsibilities specific to the engagement partner are incorporated in ISA 220 (with the definition of engagement partner being included in ISQC 1 together with the firm’s responsibilities for establishing policies and procedures to deal with the process of identifying and assigning appropriate engagement partners to audit engagements.) Many other requirements that can be found in other ISAs including ISA 230;³¹ ISA 240;³² ISA 300,³³ ISA 315 (Revised) include requirements that are the responsibility of the engagement partner. For audits of group financial statements, ISA 600 addresses responsibilities of the group engagement partner.³⁴ It has been noted that presenting the requirements for the engagement partner’s responsibilities throughout the ISAs in this manner may make the practical application of the requirements more difficult, and in particular makes it challenging for engagement partners to determine if they personally have fulfilled all their responsibilities in accordance with the ISAs.
63. The engagement partner is responsible for the auditor’s report that is issued on behalf of the firm. In many jurisdictions, the engagement partner is either named in the auditor’s report, or signs the report in his or her own name.³⁵ In some cases and pursuant to law, regulation or custom within a jurisdiction, in addition to or instead of the engagement partner, other partners are named in or sign the auditor’s report. It has been observed that the ISAs do not address such circumstances and

²⁸ ISA 220, paragraph A13

²⁹ ISQC 1, paragraphs 26–28

³⁰ ISA 220, paragraphs 12–13

³¹ ISA 230, *Audit Documentation*

³² ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

³³ ISA 300, *Planning an Audit of Financial Statements*

³⁴ ISA 600 sets out with more specificity than the other ISAs the responsibilities of the group engagement partner in relation to the group audit engagement. ISA 600 also clearly differentiates requirements that are the responsibility of the group engagement partner and which are the responsibility of the group engagement team.

³⁵ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, requires that the name of the engagement partner be included in the auditor’s report on a complete set of financial statements for a listed entity

therefore questions have been raised as to whether the ISAs should contain appropriate requirements as to what the responsibilities of an individual being named in or signing the auditor's report are when such individual is not also the engagement partner.³⁶

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

64. In defining the engagement partner, ISQC 1³⁷ and ISA 220³⁸ establish the overall responsibility of the engagement partner for the performance of the audit engagement and the issuance of the resulting auditor's report on that engagement. ISQC 1 also addresses the responsibility of a firm to assign responsibility for an audit engagements to an engagement partner,³⁹ including the need to establish policies and procedures requiring that the engagement partner has the appropriate competence, capabilities and authority to perform the role.
65. ISA 220 also includes requirements that address the need for the audit engagement partner to take responsibility for the direction, supervision and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements;⁴⁰ reviews being performed in accordance with the firm's policies and procedures;⁴¹ being satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report;⁴² and for the auditor's report being appropriate in the circumstances.⁴³
66. To facilitate compliance with these requirements, ISA 220 provides guidance, including setting forth in paragraph A13 what direction of the engagement team may involve, and guidance in the area of supervision in paragraph A15. Paragraphs A16 through A19 address performance of reviews and paragraph A20 addresses situations where a member of the engagement team has expertise in a specialized area of accounting or auditing.
67. ISQC 1⁴⁴ and ISA 220⁴⁵ include requirements and related application material that address the firm's and engagement partner's responsibilities, respectively, relating to policies and procedures for the acceptance and continuance of client relationships and specific engagements. Specifically:
- ISQC 1 includes application material to the requirements relating to accepting or continuing an engagement that highlight consideration of whether the audit firm is able to complete the engagement within the reporting deadline as being relevant to the determination as to whether or

³⁶ This does not include situations where firms provide for the ability of a partner within the same firm as the engagement partner to authorize, on behalf of that engagement partner, the signing of the auditor's report in the name of the firm or the engagement partner or both, subject to firm policies and procedures that address such situations having been satisfied. For example, such circumstances may arise when the engagement partner has satisfied himself or herself that the audit has been properly completed and that an appropriate auditor's report has been drafted, but may be temporarily unavailable when the auditor's report is formally released or issued.

³⁷ ISQC 1, paragraph 12(c)

³⁸ ISA 220, paragraph 7(a)

³⁹ ISQC 1, paragraph 30

⁴⁰ ISA 220, paragraph 15(a)

⁴¹ ISA 220, paragraph 16

⁴² ISA 220, paragraph 17

⁴³ ISA 220, paragraph 15(b)

⁴⁴ ISQC 1, paragraphs 26-28

⁴⁵ ISA 220, paragraphs 12-13

not the audit firm has the appropriate resources to accept an engagement.⁴⁶ This concept is not currently addressed in ISA 220; and

- ISQC 1 requires the firm to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm can comply with relevant ethical requirements.⁴⁷ ISQC 1 requires the firm to establish policies and procedures to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including independence requirements.⁴⁸ ISA 220 requires the engagement partner to remain alert for non-compliance with relevant ethical requirements by members of the engagement team, and to determine (in consultation with others in the firm) the appropriate action when noncompliance is identified.⁴⁹

68. In addition to indicating that the group engagement partner is responsible for the direction, supervision and performance of the group engagement and for whether the auditor's report is appropriate in the circumstances,⁵⁰ ISA 600 sets out specific responsibilities for the group engagement partner, including in respect of:

- Acceptance and continuance and agreeing the terms of engagement.⁵¹
- Determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of components, and whether the group engagement team will be able to be sufficiently involved in any work performed by component auditors.⁵²
- Reviewing the overall audit strategy and audit plan.⁵³
- Evaluating the effect on the group audit opinion of any uncorrected misstatements and any situation where there has been an inability to obtain sufficient appropriate audit evidence.⁵⁴

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

69. In its discussions about possible responses to address the issues, the IAASB identified the following possible actions:

- Providing further clarity in ISA 220 about what is meant by performance, direction, supervision and review by the engagement partner, either by strengthening the requirements or enhancing the application material that discusses the responsibilities of the engagement partner in relation to these matters. For example, this may include adding more specificity as to the engagement partner's responsibilities, such as:

⁴⁶ ISQC 1, paragraph A18

⁴⁷ ISQC 1, paragraph 26(b)

⁴⁸ ISQC 1, paragraphs 20-25 and A7-A17

⁴⁹ ISA 220, paragraphs 9-10 and A4-A5

⁵⁰ ISA 600, paragraph 11

⁵¹ ISA 600, paragraphs 12-14

⁵² ISA 600, paragraph 12

⁵³ ISA 600, paragraph 16

⁵⁴ ISA 600, paragraph 45

- Providing more direction and specificity as to what audit documentation is required to be reviewed by the engagement partner and the nature of the related review procedures.
- Placing more emphasis on the need for consideration that there are adequate resources for the engagement, including the suitability of the engagement team members' skills, competence and experience, the need for auditor's experts and the sufficiency of time available to perform the engagement before the reporting deadline.
- Inclusion of examples that illustrate what the engagement partner can do to demonstrate proactive and appropriate direction, supervision and review in various situations that have been highlighted as not being specifically addressed in the ISAs or not addressed in sufficient detail, for example, where there are access issues, when other auditors are involved in the audit engagement or where ADMs are used.
- Adding and building on the concepts in the AQ Framework⁵⁵ relating to active involvement of the engagement partner in the risk assessment, planning, supervision and review of the work performed, to the extent feasible, either as requirements or application material.
- Strengthening the requirements or enhancing the application material that discusses the responsibilities of the firm and the engagement partner in relation to decisions regarding acceptance and continuance of client relationships and specific engagements. For example, building on the concepts in the AQ Framework related to values, ethics and attitudes in relation to engagement acceptance and continuance decisions.
- Clarifying that, as part of their responsibilities, engagement partners should be appropriately involved at all stages of the audit (i.e., planning, execution and completion).
- Adding an appendix to ISA 220 that indicates where the responsibilities of the engagement partner, both requirements and application material, are articulated within the ISAs. Consider a similar appendix to ISA 600 that would articulate the responsibilities of a group engagement partner.
- Consideration of requirements or application guidance to specifically address situations where an engagement partner is not located where the majority of the audit work is performed. This may include providing more clarity as to the responsibilities of the engagement partner in these situations and expanded guidance as to how the responsibilities for direction, supervision, review and for the performance of the audit engagement are expected to be addressed, such that the engagement partner can be in a position to take responsibility for the overall quality of the engagement and the auditor's report.
- Consideration of whether to add requirements or application guidance to address situations when an engagement partner has taken responsibility for the engagement and the auditor's report, but a partner other than the engagement partner signs or is named in the auditor's report, including whether some minimum level of performance requirements should be established as to the necessary level of involvement by such individuals in or about the audit engagement.

70. Lastly, it has been suggested, for example, that the situations relating to the signing of the auditor's report set out in paragraph 63 above, could be acknowledged in the ISAs, and consideration given to

⁵⁵ The AQ Framework, paragraph 68, sets out the key attributes for the engagement partner at the engagement level, including that the engagement partner is actively involved in risk assessment, planning, supervising, and reviewing the work performed.

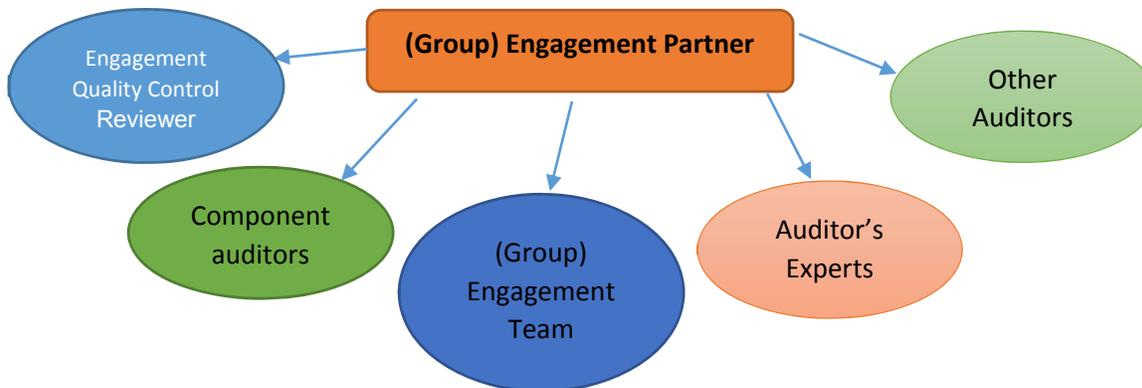
clarifying the responsibilities of such individuals, for example, such individuals could at a minimum be expected to perform the same procedures that an engagement quality control reviewer would perform. On the other hand, it has also been observed that there are generally local laws, regulations or customs that govern such practices and that requirements and guidance are therefore better established by local regulators or NSS.

Question

QC2. Which of the actions outlined in paragraphs 69–70, would be viewed as most meaningful to address issues related to responding engagement partner responsibilities? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Under what circumstances, in your view, could someone other than the engagement partner sign the auditor's report? In these circumstances, what is the work that this person should have to undertake to be able to sign the auditor's report?

Others Involved in the Audit



71. Dependent on the circumstances of the entity being audited and a wide variety of other factors, in addition to the **Engagement Partner**, one or more of the following could be involved in the audit engagement:
- **Engagement Team**—see paragraphs 72-74.
 - **Engagement Quality Control Reviewer**—see paragraphs 120-130.
 - **Component Auditors**—discussed further in the group audits section in paragraphs 202-216.
 - **Other Auditors**⁵⁶—see paragraphs 80 and 84 w.
 - **Auditor’s Experts**⁵⁷—see paragraph 79.
72. Although the engagement partner takes overall responsibility for an audit engagement, there are also other participants in an audit engagement that influence and contribute to the overall quality of the engagement and support the engagement partner in planning and performing it. It is the engagement partner’s responsibility to be satisfied that the engagement team, and any auditor’s experts that are not part of the engagement team,⁵⁸ collectively have the appropriate competence and capabilities to perform the audit engagement.⁵⁹
73. In relation to the engagement team, the AQ Framework notes a key attribute influencing audit quality is that the staff performing detailed “on-site” audit work has sufficient experience, its work is appropriately directed, supervised and reviewed, and there is a reasonable degree of staff continuity. The engagement partner has a critical role to play in encouraging and causing the engagement team to embrace and exhibit the values, ethics and attitudes necessary to support a quality audit.
74. As the environment continues to evolve, and become more complex, the composition of the engagement team, and others participating in the audit and where they are located, is changing, and may now increasingly include:
- Members of the engagement team with expertise in specialized areas of accounting or auditing (e.g., individuals with specific expertise in particular accounting standards or industry-specific expertise).
 - A variety of different auditor’s experts (e.g., valuation experts, environmental experts, actuarial experts).
 - Engagement team members situated at different locations or as part of an ADM (and sometimes located in another jurisdiction) (ADMs are discussed further in paragraphs 101-107).
75. Group audits are addressed by ISA 600, which contains requirements and guidance dealing with the involvement of component auditors. ISA 600 assists the group engagement partner in meeting the requirements of ISA 220 where component auditors perform work on financial information of

⁵⁶ For purposes of this discussion, other auditors includes service auditors.

⁵⁷ This ITC includes discussion about the IAASB’s priority projects on professional skepticism, quality control and group audits. The reference to auditor’s experts is presented for completeness, but issues and concerns related to using an auditor’s expert are only very briefly discussed in this ITC.

⁵⁸ The term engagement team is defined to exclude any auditor’s experts that are engaged by the firm or a network firm, i.e., auditor’s internal experts (those that are employed by the firm or a network firm) would be considered members of the engagement team.

⁵⁹ ISA 220, paragraph 14

components. ISA 600 also acknowledges that a component auditor may express a separate opinion on the financial information of a component⁶⁰ and issue a standalone report, but the standard precludes the group engagement team from making reference in the auditor's report on the group financial statements to such a report of the component auditor (unless making such reference is required by law or regulation)⁶¹(see paragraphs 81 and 85).

76. In some cases audits may involve other auditors who are not component auditors (i.e., other auditors that do not meet the definition of component auditors).⁶² Their involvement may be a function of how an entity is structured, or the circumstances of a particular audit, for example, the audited entity may be using a SSC for transactional processing and the audit work related to the SSC may be performed by another engagement team.
77. Various issues and challenges relating to the involvement of others during the audit have been identified, and where not covered elsewhere in this ITC, are discussed below.

ISSUES

78. Concerns have been expressed by regulators and audit oversight bodies about situations where direction and supervision of the members of the engagement team does not appear adequate and the reviews of their work do not appear to have been performed properly. Similarly, concerns have been raised regarding the direction, supervision and review of the work of other auditors involved in the audit (including in the case of group audit engagements, component auditors; however these issues are considered further in the section on group audits section of this ITC).
79. In particular, questions pertaining to the competence and capabilities of the engagement partner and engagement team have arisen in certain circumstances, such as audits of financial institutions, or others in which fair value measurements are prevalent. In such circumstances, the consideration of the need to involve team members with specialized skills or knowledge or an auditor's internal or external expert, or to undertake consultations within the firm, likely become more important to achieve a quality audit. Some firms are operating in a manner that brings the necessary expertise "in house" to support complex engagements, such as audits of financial institutions. However, this approach may not be feasible for all firms, including SMPs. Using an "in house" or internal expert does not relieve the engagement team from its responsibilities to evaluate the adequacy of an auditor's expert's work. Concerns have also been raised about situations where the auditor's considerations around using the work of auditor's experts, such as understanding the expert's field of expertise and evaluating the adequacy of the expert's work, are not adequately performed or demonstrated.
80. Paragraph 2 of ISA 600 notes that ISA 600 may be adapted as necessary when an audit is not a group audit, but other auditors are involved; however the ISAs do not provide any additional clarity as to the circumstances when this paragraph would be relevant or how ISA 600 can or should be adapted in order to assist the engagement partner in addressing the requirements of ISA 220. Concerns have been raised that the lack of explicit guidance has resulted in inconsistency about how

⁶⁰ ISA 600, paragraph 3

⁶¹ ISA 600, paragraph 4

⁶² In situations where the entity uses a service organization, other auditors may be involved. ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, addresses the relevant audit considerations in these situations, including the ability of the auditor to use the report of the service auditor as audit evidence.

other auditors are addressed in such circumstances, and in particular in situations when the engagement partner is not located where the majority of the audit work is performed.

81. As discussed in the group audits section (see paragraphs 210–216), group engagement teams may be faced with situations where it is challenging and in some cases almost impossible to have the necessary level of involvement in the work of component auditors (e.g., in the case of non-controlled components where access to either or both of the component and the component auditors may be restricted). In some of these situations, a component auditor may issue a separate reports on the financial information of the component. The current ISA provides for the ability to use the audit evidence on which such audit opinions are based, but precludes the ability of the group engagement team to make reference in the auditor’s report to the reports containing such opinions. It has been observed that in many cases the reports that are issued by component auditors on component’s financial information are “general-purpose” reports and therefore it may be appropriate to revisit the requirements in ISA 600 to explore whether, in what circumstances and subject to what requirements, it might be possible to provide for the ability of the group engagement team to make reference in the auditor’s report on the group financial statements to the report of the component auditor as part of the evidence that supports the overall opinion on the group financial statements.
82. It has also been questioned as to whether more transparency about the audit could be provided by permitting or requiring disclosures in the auditor’s report about the role of other auditors in the (group) audit. In exploring changes to the ISAs during the recently completed Auditor Reporting project, the IAASB initially explored this question; however in finalizing the auditor reporting standards, and based on feedback from respondents to that consultation, the IAASB agreed to not pursue this matter any further. However, there continues to be feedback that providing users with information that enables them to evaluate the other auditors in the same manner that they evaluate the group auditor may be helpful to increased transparency about the audit.
83. Lastly, in many places in the ISAs the requirements focus on the responsibilities of the ‘auditor.’ The use of the term ‘auditor’ may refer to the firm, engagement partner or engagement team, as appropriate in the circumstances, recognizing that the engagement partner may delegate tasks to others on their behalf. This does not detract from the overall responsibility of the engagement partner for the audit and the auditor’s report, but allows tasks to be delegated to the others involved in the audit. However, it may be unclear in certain instances that some relevant tasks should not be delegated, and should remain the responsibility of the engagement partner.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

84. The circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the ISAs (including situations when the definitions of group audit, component and component, auditors as set forth in ISA 600 do not apply to a particular engagement). Accordingly, when other auditors (that are not component auditors or not otherwise part of the engagement team) are involved in an audit engagement, the IAASB could consider whether specific requirements and guidance for these situations is warranted. In making this consideration and in developing possible requirements and guidance, the IAASB believes that would be important to first focus on the core principles established by ISA 220, in particular those core principles in relation to the engagement partner’s responsibilities and the necessary direction, supervision and review of the work of the other auditor. The IAASB could also give further consideration to incorporating matters such as the

assessment of professional competence and capabilities of the other auditors, and evaluation of the sufficiency and appropriateness of the work they have performed.

85. As part of its group audits project, the IAASB could consider exploring whether to revisit the requirements that currently preclude the ability to make reference to the report of another auditor. The IAASB realizes however that this subject was the subject of extensive debate when ISA 600 was developed and finalized and it was the clear view of the IAASB at that time that it was not appropriate to allow for such reference to be made (other than where required by law or regulation.) The IAASB notes however that making reference to the work of other auditors is permitted in certain jurisdictions (including the United States).
86. In addition, the IAASB intends to further explore whether greater transparency in the auditor's report about the involvement of others in the (group) audit may be beneficial (e.g., in addition to exploring the ability to making reference to the report of another auditor, relevant disclosures may include describing the nature and extent of involvement of others in the audit, including component auditors, other auditors and auditor's experts.⁶³
87. As the IAASB progresses its work on its priority projects, in looking at clarifying the requirements in ISQC 1, ISA 220 and ISA 600, the IAASB may also consider whether certain responsibilities attributed to the "auditor" should be more specifically characterized as responsibilities of the engagement partner or the engagement team.
88. The IAASB will also consider, as part of its consultations on its future Work Plan, the need for further consideration about as the involvement of auditor's experts.

Question

QC3. Which of the actions outlined in paragraphs 84-88, would be viewed as most meaningful to address issues related to others participating in the audit? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Should the IAASB explore revisiting the requirements in ISA 600 that currently preclude the ability to make reference to the work of another auditor? If not, why not?
- (b) Should the IAASB revisit the question of providing increased transparency in the auditor's report about the involvement of others in the engagement?

The Firm's Role in Supporting Audit Quality

89. In the current evolving environment, firms are operating in many and varied ways, adding new levels of complexity to matters related to both the firm's and the engagement partner's responsibilities in

⁶³ The IAASB notes that the PCAOB is close to finalizing a rule that will require auditors of U.S. issuers (listed entities) to file a form with the PCAOB that describes the involvement of certain participants (including other auditors) in the audit engagement. The information included on the form will be made available on the PCAOB's website. See <http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx> for more information.

support of a quality audit, and potentially affecting the way that engagement teams are structured and how audit engagements are performed.

90. In particular, the IAASB believes it is necessary to give further consideration to two complex issues that involve firms:

- Those operating through arrangements that share:
 - (i) Common policies and procedures for performing the work (for example, audit methodologies);
 - (ii) Common quality control policies and procedures; or
 - (iii) Common monitoring policies and procedures.⁶⁴
- Those with models of service delivery that are different to the traditional engagement team structures. These are sometimes referred to as “audit firm shared service centers,” “centers of excellence,” “on-shoring,” “offshoring,” or “outsourcing” (referred to in this ITC as ADMs).

Quality Control Policies and Procedures as Part of Operating through a Network of Firms

Some audit firms operate internationally through a network of firms. Network firms often share common methodologies and quality control and monitoring policies and procedures. Some networks also share guidance in relation to values, ethics, and attitudes, and have programs to enhance the knowledge and experience of partners and staff.

- Paragraph 107 of Appendix 2 of the AQ Framework

91. ISQC 1 makes reference to the fact that some firms operate as part of a network of firms. The definition of a network in ISQC 1 contains elements that are broader than the sharing of common quality control policies and procedures and common methodologies. In reality, networks of firms vary significantly and the extent of sharing of and reliance on common quality control policies and procedures and common methodologies can vary considerably. For purposes of this ITC, the term “network of firms” (network) refers only to arrangements where firms share common quality control policies and procedures or common methodologies. The following are often observed in network arrangements:

- Firms within a network are not owned or controlled by the network entity for various reasons, including jurisdictional law and regulation, and risk and litigation management purposes.
- The extent of operational and decision-making power at the network level varies among networks and enforcement powers in relation to individual network member firms may be limited. Compliance at the individual member firm level with shared common quality control and

⁶⁴ Firms that operate through such arrangements are typically referred to as a network or network firms. International Standards define a “network” as “A larger Structure that is (a) aimed at cooperation; and (b) is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources”.

monitoring policies and procedures and common methodologies can be influenced through economic and other measures, but often cannot be centrally controlled.

92. Currently there only very limited jurisdictions with laws or regulations that govern networks and the way they are structured and managed, and where such law or regulation exist, their application would generally be limited to firms in that jurisdiction. The IAASB acknowledges that firms choose to organize themselves under many different types of arrangements, and also recognizes that its standards cannot mandate or anticipate all the ways in which firms are structured, including how they may operate within a network.
93. ISQC 1 and the ISAs do not establish any requirements at the network level nor do they address in any significant detail, a firm's ability to place reliance on network policies and procedures to address firm-level or engagement-level responsibilities for quality control.

ISSUES

94. Some firms that operate as part of a network may seek to rely on aspects of the network's system of quality control, including monitoring policies and procedures, in addressing the firm's responsibilities under ISQC 1. In relation to this, concerns have been raised by regulators and audit oversight bodies that there may be overreliance by some firms on the network's system of quality control, or reliance without an appropriate basis.
95. More specifically, regulators and audit oversight bodies have:
- Highlighted that ISQC 1 does not extend to, or address, the monitoring procedures that may, or may not be, performed at the network level.
 - Expressed concerns that networks are not adequately considering the results of external inspection findings of individual firms within the network and their implications to the network as a whole and making appropriate communications about such matters within the network.
 - Noted concerns about their ability to access audit documentation of other firms in the network, including the ability of firms within the network to share information with them.
96. At the engagement level, issues have arisen about whether, how and under what circumstances engagement teams can rely on the common systems of quality control when using work performed by other auditors from the same firm or a network firm. Specifically, concern has been raised about the group engagement team placing reliance on the firm or network quality control policies and procedures without due consideration of an appropriate basis for doing so. For example, a group engagement team may place reliance, without conducting a proper assessment, on network level policies and procedures relating to independence, and competence and capabilities of the component auditor, when the component auditor has the same quality control policies and procedures as the group engagement team (e.g., is an firm that operates within the same network as the firm to which the group engagement team belongs).

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

97. ISQC 1 contains a requirement⁶⁵ for the firm to comply with when the firm, operating as part of a network, seeks to rely on the network's common monitoring policies and procedures. These requirements include communication by the network:
- At least annually, of the overall scope, extent and results of monitoring process to the firm's within the network; and
 - Of any deficiencies in the system of quality control to the firms in the network so the necessary action can be taken.
98. ISA 600 sets out application material relating to considerations where the group engagement team's procedures may be affected by whether the group engagement team and component auditor have common policies and procedures for performing the work, common quality control policies and procedures or common monitoring policies and procedures.⁶⁶ ISA 220 provides for the ability of the engagement team to rely on the firm's system of quality control, unless information provided by the firm or other parties suggest otherwise.⁶⁷ This may include, for example, competence of personnel, independence, maintenance of acceptance and continuance systems, and adherence to applicable legal and regulatory requirements through the monitoring process.⁶⁸

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

99. Clarity in ISQC 1 and ISA 220 about what should be considered and documented by the individual firm as a basis for the reliance on network policies and procedures (including for example, a common audit methodology or audit technology) is important. Specifically, actions that the IAASB could take include:
- Revisiting the existing requirements and application material in ISQC 1 to more explicitly address the considerations about the extent to which firms can rely on shared quality control and monitoring policies and procedures in designing policies and procedures to comply with ISQC 1 at the firm level. This could include, for example, setting out the basis for such reliance, what the firm is required to do at the firm level and the engagement level in relation to the reliance being placed on network firm quality control and monitoring policies and procedures. Such requirements would, however, also need to consider the level of effort necessary for an firm to comply with such requirements to demonstrate an appropriate basis for reliance on network quality control policies and procedures. In this regard, it may be necessary for the IAASB to explore alternatives that have similarities to the "service organization" concept followed by corporate entities that choose to rely on others for certain aspects of their financial reporting obligations and the related reporting by service auditors, i.e., using the principles set out in ISA 402.
 - Strengthening the requirements and application material in ISQC 1 in relation to inspections that have taken place across the network, including, for example more specificity about:

⁶⁵ ISQC 1, paragraph 54

⁶⁶ ISA 600, paragraphs A33–34

⁶⁷ ISA 220, paragraph 4

⁶⁸ ISA 220, paragraph A2

- (i) The impact on the firm, and for an engagement if applicable, of the outcome of these inspections, taking into account that law or regulation may preclude the sharing of information.
- (ii) How the firm responds to the inspection findings.
- (iii) The impact on the firm's own system of quality control, including monitoring policies and procedures, designed to comply with ISQC 1.

100. In exploring changes, it is recognized that network and firm structures may be highly influenced by law or regulation in the various jurisdictions where networks and individual firms are established. As such, the IAASB believes it would be difficult to establish requirements for networks themselves.

Exploring the Potential Effects that Firm's Changing Business Models and Structures Have on Audit Quality

101. In conducting audits, some firms are developing ADMs that are different to the traditional engagement team structures. These responses are reactions to changes in the global business environment, technology developments that better facilitate the functioning of virtual engagement teams and, in some cases, to changes in how the entities being audited are organizing themselves. Examples of ADMs include:

- Elements of the firm's system of quality control that are performed in a centralized location (e.g., independence monitoring).
- Certain standard audit procedures for all or many of the firm's audit engagements that are performed by dedicated central resources (e.g., centralized functions to manage confirmation processes).
- Centralized resources that are available to perform audit procedures at the request of individual engagement teams.

In some cases, these centralized resources may be physically located in a foreign jurisdiction or in a location other than where the majority of the engagement team is located.

102. The manner in which ADMs are structured, how they operate (including where the auditors are located), and the approaches to the oversight of the work performed can vary significantly across firms.

ISSUES

103. Concerns have been expressed about quality control at ADMs, in particular by regulators and audit oversight bodies. Specifically, concerns have been raised in relation to:

- The sufficiency of the extension of a firm's leadership and oversight at centralized locations or over other centralized resources, particularly those that are in remote locations, as part of its internal systems of quality control.
- The sufficiency of a firm's established policies and procedures to govern the work that is performed at the centralized locations or by other centralized resources, and whether sufficient documentation exists to demonstrate how the audit team assessed these in relation to the audit being performed.

- The competency of the personnel performing the procedures in relation to the complexity of the procedures being performed and the implications of the remoteness of the personnel from the engagement team it is supporting, including the inability to interact with management of the entity in completing specific tasks.
- The sufficiency of supervision of persons performing procedures at these centralized locations or other centralized resources, including the sufficiency of the review of the procedures performed. For example, it has been suggested direction and supervision of individuals that are part of ADMs may not be as rigorous as the direction and supervision of other members of the engagement team that they are supporting. It has also been noted that it may be necessary to tailor the necessary level of direction and supervision to take account of differences in matters such as language, culture, background, or levels of experience of individuals in the ADM.
- Whether the procedures performed at these centralized locations or by other centralized resources, including evidence of review, is appropriately documented.

104. Firms have informally indicated that, where applicable, their internal methodologies require at least the same policies and procedures in respect of supervision of procedures performed at the centralized locations or by other centralized resources as that of the engagement team and, in some instances, noted incremental quality control procedures in this area. Examples of the types of policies and procedures developed include:

- Minimum education and experience requirements for personnel at the centralized location or other centralized resources;
- Obtaining confirmation by personnel at the centralized location or other centralized resources that they meet those educational and experience requirements;
- Limiting the work to be performed by the personnel at the centralized locations or other centralized resources to only pre-determined specific procedures (with consideration given as to the extent of professional judgment needed to perform those procedures);
- Providing detailed instructions as to the performance of those procedures; and
- Direction, supervision and review requirements that take into consideration the experience of the people undertaking the work, and the nature of the work being performed.

REFERENCES TO EXISTING GUIDANCE AND APPLICATION MATERIAL

105. Neither ISQC 1 nor the ISAs contain explicit requirements or application material related to ADMs. However, it is understood that firms are applying ISQC 1 and ISA 220 in situations involving ADMs and continue to develop their own internal methodologies in respect of the types of work that may be performed at centralized locations or by other centralized resources, as well as guidelines as to how that work should be performed.⁶⁹

⁶⁹ Similar to circumstances discussed in IAASB Staff Audit Practice Alert, *Responsibilities of the Engagement Partner in Circumstances when the Engagement Partner is not located where the Majority of the Audit Work is Performed*, ISQC 1 and ISA 220 apply in these circumstances.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

106. Given the evolving use of ADMs in practice, the IAASB believes it would be useful for ISQC 1 and the ISAs to acknowledge the use of ADMs, and emphasize the need for appropriate policies and procedures for these structures as part of the firm's quality control system and at the engagement level for the direction, supervision, performance and review of their work, specifically in instances where centralized locations or centralized resources are utilized in conducting audits and the people performing the work are considered to be part of the engagement team. The IAASB recognizes the evolving nature of these arrangements, and in making changes for ADMs, will consider the need to maintain the flexibility of the standards as the nature and extent of use of ADMs continues to change. It may be helpful to clarify:

- The engagement partner's responsibility for the direction, supervision and review of the work performed, regardless of who performs the work and where it is performed;
- How these centralized locations or other centralized resources are viewed in the context of the definition of engagement team set out in the ISAs; and
- That firms' systems of quality control need to take into account the implications of using ADMs, and the need for appropriate policies and procedures to safeguard against inappropriate use of ADMs or ineffective oversight of work performed by auditors in an ADM.

107. Specifically, the IAASB has considered a number of possible actions, including strengthening ISQC 1 and ISA 220 to provide additional requirements or application material, or clarifications of existing requirements and application material, to more explicitly address supervision and review of procedures performed at a centralized location or by other centralized resources. These could include strengthening the auditor's consideration of:

- The risk of material misstatement associated with the account or balance on which the procedure is being performed, such that appropriate safeguards are put into place to assess:
 - The level of complexity of the procedure; and
 - The level of judgment required to perform the procedurein relation to the competencies and experience of the personnel at the centralized location or other centralized resources tasked with performing the procedure.
- Whether the procedure is capable of being performed at a location that is remote from the engagement team and the client and, in particular, not require face-to-face interaction with the client to properly complete the procedure.
- Whether performance of the procedure is capable of being directed and supervised remotely.
- Whether communications with management or those charged with governance noting the planned use of personnel at a centralized location or other centralized resources in executing the audit is necessary.
- The nature and extent of documentation required by both those performing the procedure at the centralized location or by other centralized resources and those directing and supervising the performance of the procedure.
- Whether the performance of the procedure at a remote location would result in a breach of client confidentiality, or any legal or cross-border restrictions.

- Whether policies and procedures to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation are appropriately designed in the context of procedures performed at a centralized location or by other centralized resources.

The IAASB notes however that changes to its standards are not going to solve issues in all jurisdictions where regulators face challenges in obtaining access to the working papers prepared in other jurisdictions because these challenges generally arise because of restrictions imposed by local law or regulation.

Questions

QC4 Which of the actions outlined in paragraphs 99 and 106-107, would be viewed as most meaningful to address issues related to operating through a network of firms and firms changing business models and structures? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you agree that it would be possible to develop requirements and guidance in the IAASB's standards, which are focused on firms and engagements, at the network level? Please provide a basis for your views. What, if anything, in your view could the IAASB do, including in what specific areas, to address the concerns being expressed about networks of firms?
- (b) What kinds of audit procedures are being performed at these ADMs? What quality control policies and procedures apply to the individuals operating at the ADMs and are these appropriate in the circumstances? In your view, should the requirements in ISQC 1 and ISA 220 specifically require minimum quality control policies and procedures for these types of arrangements, and what should these address?

QUALITY CONTROL SPECIFIC MATTERS

108. In addition to those matters discussed in relation to a QMA and in the section above relating to crossover issues / those issue relevant to more than one project, the following focusses on other matters relevant to the revision of ISQC 1⁷⁰ and ISA 220.

Governance of the Firm, Including Leadership Responsibilities for Quality

109. Firm leadership has a vital role in promoting a culture that stresses the importance of the role of the audit in the public interest and therefore, the importance of audit quality. Firm leaders are responsible for establishing policies and procedures to achieve quality-related objectives, monitoring compliance with such policies and procedures and instilling a culture of accountability for quality throughout the firm in the context of all the services it provides. Governance of a firm includes leadership

⁷⁰ ISQC 1 also applies more broadly to firms that conduct engagements other than audits of historical financial statements (including compilation engagements, agreed-upon procedures engagements, review engagements and other assurance engagements). This ITC focuses on ISQC 1 as it applies to audits of historical financial statements. In considering changes to the standard and how it is structured, consideration will however also be given to clarifying how ISQC 1 applies to these other types of engagements.

responsibility for quality, oversight by firm leadership over the implementation of responses to risks of the firm not meeting its quality objectives and the oversight of firm leadership.

110. Since ISQC 1 was issued, there have been developments by a variety of policymakers and others that emphasize the principles of good governance. These include, for example, development of governance codes and quality frameworks that apply specifically to firms⁷¹ and refinement of governance codes that are intended for corporate organizations.⁷²

111. The IAASB is of the view that effective firm governance and leadership should include structures and mechanisms for:

- Oversight of firm leadership that appropriately reflects the circumstances of firm;
- Direct responsibility of firm leadership, and accountability of appropriate personnel within firm leadership, for quality.
- Establishing policies and procedures to provide for appropriate supervision, control and monitoring of quality within the firm;
- The allocation of responsibilities, at the firm and engagement level;
- Generating a culture of openness that encourages collaboration and consultation; and
- Resolving conflicts of interest that may arise in relation to the performance of audit services versus other firm services (e.g., allocation of firm resources).

112. Lastly, concerns have been brought to the attention of the IESBA in relation to the lack of identification of appropriate personnel within firm leadership to be responsible and accountable for independence matters.

ISSUES

113. ISQC 1 does not provide much detail or guidance as to what is expected from firm leadership, nor does it include well-understood and commonly used terminology such as “tone at the top” and “leading by example.” ISQC 1 also does not include guidance related to the important role that firm leaders play in sustaining and continually improving audit quality through effective leadership at the firm level, or that addresses the concept of accountability of firm leadership. These matters have been identified by regulators and audit oversight bodies as possible missing components within ISQC 1. Although accountability and responsibility are often used interchangeably, responsibility is slightly narrower in scope than accountability. Responsibility refers to being in charge of, or owning, the task,

⁷¹ For example, *The Audit Firm Governance Code* (Institute of Chartered Accountants in England and Wales and UK Financial Reporting Committee); Oversight and transparency, A code for audit firms holding a Public Interest Entity (PIE) licence (Nederlandse Beroepsorganisatie van Accountants); European Commission Directive 2006/43/EC of the European Parliament and Council of 17 May 2006 and Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014; US Center for Audit Quality (CAQ) Approach to Audit Quality Indicators; and ISO 9001 (2015). The IAASB acknowledges that there may be other firm specific codes and frameworks that may be relevant and welcomes feedback from respondents as to others that should be considered.

⁷² For example, the Organization for Economic Co-operation and Development, Principles of Corporate Governance; The Committee of Sponsoring Organizations of the Treadway Commission (COSO) 2013 Internal Control Framework; COSO Enterprise Risk Management (ERM) Framework; and ISO 9001 (2015). The IAASB acknowledges that there may be other corporate governance codes and frameworks that may also be relevant and welcomes feedback from respondents as to others that should be considered.

whereas accountability refers to answering with regard to the outcome of the task. ISQC 1 also does not address firm governance.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

114. ISQC 1 addresses leadership responsibilities for quality within the firm, requiring that the firm establish policies and procedures designed to promote an appropriate internal culture, recognizing that audit quality is essential in performing engagements and requiring that the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control.⁷³ ISQC 1 requires that those assigned operational responsibility for the firm's system of quality control have the appropriate experience and ability, and the necessary authority to perform those duties.⁷⁴

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

115. The IAASB believes it is necessary to evaluate whether, and if so how, firm governance could be best addressed in ISQC 1. Recognizing that firm structures vary, and are affected by law or regulation in the jurisdiction(s) in which the firm operates, the IAASB will seek to find opportunities to enhance ISQC 1 to stress the importance of governance and a focus on quality at all levels within a firm, including through the use of a QMA.

116. For example, leadership responsibilities could be clarified in ISQC 1 through additional requirements or application material or clarifications of existing requirements and application material to more explicitly incorporate commonly used and familiar terminology (e.g., "tone at the top" and "leading by example"). Further emphasis could be given in ISQC 1 to the importance of firm leadership setting an appropriate culture for the firm and for taking responsibility and being accountable for extending that culture throughout the firm. This point may be particularly relevant when considering the increasing diversity in how firms organize themselves, the manner in which they are governed, and in how engagement teams are structured.

117. In addition to addressing leadership responsibilities for quality within the firm, the IAASB is considering whether ISQC 1 should require accountability of firm leadership, or appropriate personnel within firm leadership, for matters related to quality.

118. In response to concerns in relation to firms' independence that were brought to the attention of the IESBA, it may be necessary to strengthen ISQC 1 by more specifically requiring a firm to identify appropriate personnel within firm leadership to be responsible and accountable for independence matters.

119. In the context of leadership's responsibility for the firm's system of quality control, the concept of the public interest could be explicitly incorporated into ISQC 1. Recognizing that "public interest" can have a different meaning for different stakeholders, establishing a requirement in ISQC 1 for firm leadership to act in the public interest would be difficult to design and implement. Taking into account the due process followed in standard setting, including broad stakeholder involvement, a presumption exists that the public interest is inherently achieved in faithfully applying the IAASB's International Standards. Nevertheless, it could be useful to emphasize in ISQC 1 the importance of relevant public

⁷³ ISQC 1, paragraph 18 and A4–A5

⁷⁴ ISQC 1, paragraphs 19 and A6

interest considerations in relation to the design of the firm's system of quality control. This emphasis could be incorporated into the introduction to ISQC 1 or into the application material associated with requirements relating to leadership responsibilities.

Question

QC5. Which of the possible actions outlined in paragraphs 115–119, would be viewed as most meaningful to address issues related to firm leadership responsibilities for audit quality? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you believe it is necessary to explore how the governance of a firm could be best addressed in ISQC 1?
- (b) Should ISQC 1 specifically address accountability of firm leadership, or appropriate personnel within firm leadership, for matters related to quality, including independence-related matters? If so, how should this be done, and what direction should ISQC 1 provide to firms in appointing appropriate individuals to assume these responsibilities?
- (c) Would the use by firms of a QMA to the design and implementation of their systems of quality control provide better support or context for the importance of quality-related responsibilities for firm leadership, and related accountability, and therefore better facilitate the ability of firms to address these matters?

Engagement Quality Control Reviews and Engagement Quality Control Reviewers

120. As a complement to the requirements set forth for engagement partners, ISQC 1 requires the appointment of an engagement quality control (EQC) reviewer for audits of financial statements of listed entities and the establishment of criteria by the firm to determine when other engagements should be subject to an EQC review.⁷⁵ EQC reviews are intended to involve objective evaluations of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. The performance of an effective EQC review is an important engagement level quality control, but also a key aspect of the monitoring component of a firm's system of quality control.

ISSUES

121. The ISA Implementation Monitoring project identified concerns that the requirements in ISA 220 and ISQC 1 regarding EQC reviews are not sufficiently robust, with issues being identified with respect to the following areas:

- The appropriateness of the criteria established by firms to determine which engagements are subject to a EQC review, with a view that insufficient focus is being placed on entities of particular public interest that are not listed entities.

75 ISQC 1, paragraph 19

- The selection of the EQC reviewer, including the qualifications and the objectivity of the individual selected to perform the EQC review, and consideration of the reviewer's own inspection results.
- The timing of the performance of the EQC review, specifically with respect to when the EQC reviewer becomes involved in the EQC review and the time allocated to the EQC reviewer for the performance of the review.
- The depth and the focus of the review, specifically highlighting a perception that in some cases the EQC reviewer paid insufficient attention to the assessment of and response to areas of significant risk or significant judgments made by the engagement partner and the engagement team, including how, and in which areas of the audit, the engagement team intends to utilize ADMs.
- The robustness of the documentation of the review, including citing the documents reviewed, the issues raised as part of the review and the disposition of those issues.

122. Since ISA 220 and ISQC 1 were finalized, the US Public Company Accounting Oversight Board (PCAOB) has issued AS 7.⁷⁶ A review of AS 7 has highlighted differences to the extant requirements in ISQC 1 and ISA 220, which may be potential areas for improvement in the IAASB's standards, and include:

- An objective of the performance of an EQC review.
- A requirement for an EQC reviewer to have sufficient integrity and independence to perform the review.
- A requirement for a "cooling off" period for an EQC reviewer that had previously been involved in the engagement.
- A requirement that focuses the EQC reviewer to review specific areas of the engagement, such as areas of significant risk or significant judgment.
- The concept of highlighting instances where the EQC reviewer found significant or material deficiencies in the work performed by the engagement team.

123. Application material in ISQC 1 explains⁷⁷ that an EQC reviewer does not otherwise participate in the engagement during the period of review. However, there is insufficient clarity in respect of what the period of review and participation means in this context.

SMP PERSPECTIVE

124. SMPs have identified difficulties in complying with certain of the existing requirements in ISQC 1 and ISA 220. Many SMPs need to use third-party resources as EQC reviewers. There is often limited availability of adequately qualified individuals willing to take on the additional level of risk to perform the role of an EQC reviewer, and where these individuals are identified, they are costly. The possible expansion of engagements that would require an EQC review beyond audits of listed entities (see paragraph 127) could further add to these availability and cost challenges for SMPs that have to use third-party resources as EQC reviewers.

⁷⁶ PCAOB Auditing Standard (AS) No. 7, *Engagement Quality Review*

⁷⁷ ISQC 1, paragraph A49

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

125. In addition to requiring EQC reviews for audits of financial statements of listed entities, ISQC 1 includes requirements and application material for a firm to develop policies and procedures for:

- The selection of other engagements that meet the criteria established by the firm and that should therefore be subject to an EQC review;
- The nature, timing and extent of the EQC review;⁷⁸ and
- Determining the eligibility of personnel to perform the role of the EQC reviewer.⁷⁹

126. ISQC 1⁸⁰ and ISA 220⁸¹ include requirements and application material discussing the engagement partner's responsibilities and the EQC reviewer's responsibilities with respect to the performance of the EQC review (including what the review should include and specific incremental requirements for EQC reviews for audits of financial statements of listed entities), including documentation requirements.⁸²

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

127. Strengthening the requirements and application material in ISQC 1 and ISA 220 related to EQC reviews may contribute positively to enhance audit quality. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- Expanding the types of engagements that would require an EQC review beyond audits of listed entities. These changes may result in other entities of particular public interest, for example, financial institutions (such as banks, insurance companies, and pension funds), being subject to EQC review requirements. This may be achieved by one, or a combination of the following:
 - Elevating the application material in ISQC 1 and ISA 220 concerning criteria for selecting those engagements subject to EQC review to requirements.
 - Strengthening the requirements and guidance in relation to the establishment of criteria by the firm for selecting those engagements that require an EQC review.
 - Adding a new requirement, or clarifying the existing requirement, to focus on the selection of engagements for review based on identified risks of the engagements, such that engagements with higher audit risk or, if a firm is using a QMA, those that pose greater risk of negatively affecting the firm's ability to meet its quality objectives would be more likely to be selected.
 - Requiring an EQC review for audits of entities of particular public interest other than listed entities. The IAASB could explore setting a minimum definition or describing characteristics of entities of particular public interest other than listed entities that would be required to be taken into account in setting criteria for EQC reviews (for example, entities with a large number and wide range of stakeholders and considering the nature of entities with certain characteristics,

⁷⁸ ISQC 1, paragraphs 35–36 and A41–A43

⁷⁹ ISQC 1, paragraphs 39–41 and A47–A51

⁸⁰ ISQC 1, paragraphs 37–38 and A44–A46

⁸¹ ISA 220, paragraphs 19–21 and A23–A31

⁸² ISQC 1, paragraph 42, and ISA 220, paragraph 25

including size of the business). The IAASB recognizes however the difficulty of defining public interest entities (PIEs) on a global basis, given the various definitions or interpretations across different jurisdictions.

- Strengthening the requirements and application material regarding the selection of the EQC reviewer. For example, elevating the application material in ISQC 1 concerning policies and procedures to maintain objectivity of the EQC reviewer⁸³ to requirements. The IAASB may also consider a requirement for a firm to establish a policy that defines the period of time that an individual who had previously been involved in the audit, including in the role of the engagement partner, would not be eligible to fill the role of the EQC reviewer.
- Strengthening the documentation requirements in ISA 220⁸⁴ to include the timing and the substance of the EQC review procedures performed, and significant or substantive discussions of the engagement partner and the EQC reviewer.
- Adding application material to ISA 220 that provides guidance for the use of subject-matter experts or other qualified individuals, separate from subject-matter experts that assisted the engagement team, to assist an EQC reviewer where appropriate. When an EQC review is not performed, subject-matter experts or other qualified individuals could be used as part of a pre-issuance review (see paragraphs 133 and 138).
- Strengthening the requirements and application material in ISA 220 by further specifying the nature and extent of matters to be considered by the EQC reviewer. This may include, for example, emphasizing:
 - The importance of the EQC reviewer's responsibilities for assessing the judgments made by the engagement partner and the engagement team in determining the areas of significant risk and procedures performed in responding to those significant risk areas.
 - The need for involvement in the review of components in a group audit situation as appropriate.

128. Given the importance and value placed on the role of the EQC review by stakeholders, particularly investors and regulators, the IAASB is considering alternatives to give further prominence to, and emphasize the importance of, the EQC review. In addition to the possible actions above to strengthen requirements and application material, the IAASB would welcome stakeholder views on the following considerations in this context:

- Development of a separate EQC review standard, which could have the following advantages and disadvantages:

Advantages

- Greater prominence of the contribution of the EQC review to audit quality through increased focus being provided through use of a separate standard.
- May allow for greater elaboration of requirements and application material for an EQC review (including proportionate application or application to other types of assurance or related services engagements).

⁸³ ISQC 1, paragraph A49

⁸⁴ ISQC 1, paragraphs 24–25

- May help address the issues of scalability of ISQC 1 which have been highlighted by SMPs.

Disadvantages

- Linkages to, and with, the overall framework of ISQC 1 may be missed.
- Increased potential for duplication.
- Undue prominence on an EQC review in relation to other important factors in quality control, in particular the role of the engagement partner and other reviews that may be undertaken (see paragraph 69).
- The possibility of providing additional transparency in the auditor's report, for example, by communicating in the auditor's report as to whether the audit of an entity other than a listed entity was subject to an EQC review. However, any such communication would need to take into account the fact that users of the auditor's report could inadvertently form a negative view about the quality of an audit that has not been subject to an EQC review, notwithstanding that such an audit may not have met a firm's criteria for selection.

129. The role of the EQC reviewer in relation to the engagement partner could be clarified in ISQC 1 and ISA 220 to address concerns over the balance of the respective responsibilities and make sure that changes to ISQC 1 and ISA 220 do not result in the requirements and responsibilities of the EQC reviewer exceeding those of the engagement partner.

130. Additionally, the IAASB could consider amendments to ISA 260 (Revised)⁸⁵ to require the engagement partner's communications with those charged with governance of the entity to include communications that the engagement is subject to an EQC review and the role and function of the EQC review. In addition, the IAASB may consider whether, and in what circumstances, communication between the EQC reviewer and those charged with governance of the entity may be appropriate.

Question

QC6. Which of the possible actions outlined in paragraphs 127-130, would be viewed as most meaningful to address issues related the EQC review and the EQC reviewer? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Should ISQC 1 mandate EQC reviews beyond listed entities? If yes, what other entities should be considered and how could the IAASB best define these entities? If no, please explain why.
- (b) Do you believe it is necessary for the IAASB to require in ISQC 1 that firms define the minimum period of time between when an individual has been the engagement partner and when that individual would be eligible to be the EQC reviewer? If yes, how do you think this should be done? If no, please explain why.

85 ISA 260, *Communication with Those Charged with Governance*

(c) Would you support the development of a separate EQC review standard? If so, please explain why. If not, please explain why.

Monitoring and Remediation

ISSUES

131. An important aspect of an effective quality control system are policies and procedures providing for regular assessment of the adequacy and effectiveness of that system, including a mechanism by which the system is evaluated and modified, as appropriate, when deficiencies are identified. While ISQC 1 contains requirements related to monitoring of a firm's system of quality control, the ISA Implementation Monitoring project and feedback from stakeholders have highlighted areas where ISQC 1 could be improved. For example, regulators and audit oversight bodies have increased demands on firms to take actions to understand the causal factors of inspection findings (i.e., perform "root cause analysis") and respond to inspection findings related to individual engagements as a means of improving audit quality. Since ISQC 1 was developed, the nature and extent of audit regulation has expanded in many jurisdictions around the world, resulting in external inspections and related findings being far more prevalent today.
132. ISQC 1 does require communication of the firm's quality monitoring results; however it does not sufficiently address requirements for firms to develop policies and procedures to address and respond to the results of inspections performed by external inspectors, such as:
- The communication of findings from external inspections related to both individual engagements and the firm.
 - How those findings may impact other engagements not selected for inspection within the firm.
 - Documentation requirements regarding the consideration of findings from inspections, including evaluation and resolution thereof.
 - Guidance on the implementation of systems or policies and procedures that focus on continual improvement, including the performance of a root cause analysis.
133. In addition to EQC reviews of some audits, many firms perform other types of reviews at different stages of an audit that are focused on achieving quality. Examples of these types of reviews include "pre-issuance" and "post-issuance" reviews. Such reviews have the objective of identifying and correcting potential engagement deficiencies but do not take the place of the EQC review. ISQC 1 does not explicitly contemplate the use of these or other external reviews in the monitoring system or as a source of identifying situations where remedial action might be necessary.

SMP PERSPECTIVE

134. SMPs have identified monitoring, including compliance with the requirements set out in ISQC 1, as one of the most difficult aspects of a quality control system to implement. These difficulties stem largely from resource constraints in general, funding the cost of compliance, and the requirement for a person external to the engagement to perform the internal inspection.⁸⁶

⁸⁶ ISQC 1, paragraph 48 (c)

135. Some SMPs have highlighted concerns arising from the impact of requirements for various reviews, such as EQC reviews (including when resources outside of the firm are needed), external resources for monitoring requirements on ISQC 1 and peer review or inspection by relevant institutions. These requirements can result in the documentation of the same audit being reviewed multiple times, leading to questions regarding whether the number of layers of quality control, when taken in total, are redundant in certain circumstances and may not lead to further enhancements to audit quality.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

136. ISQC 1 requires firms to have monitoring processes to provide reasonable assurance that the policies and procedures relating to the firm's system of quality control are relevant, adequate and operating effectively, and that at least one engagement for each engagement partner within the firm is evaluated on a cyclical basis, subsequent to the completion of that engagement,⁸⁷ and that any identified deficiencies are evaluated, communicated and remediated.⁸⁸ These requirements and related application material currently only pertain to internal inspections.

137. Although ISQC 1 does provide requirements in respect of complaints and allegations where the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and where there is non-compliance with the firm's system of quality control, the link to remediation of external inspection findings through this requirement and related application material⁸⁹ is not explicit.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

138. Strengthened requirements and new application material within ISQC 1 could lead to improved audit quality with firms achieving greater consistency in practice to respond to inspection findings of individual engagements. This could include strengthening the requirements and enhancing the application material for:

- An analysis of any external findings and appropriate responses thereto, in the same way that internal findings are considered;
- Consideration of whether inspection findings would have implications for other engagements as well as the firm's system of quality control;
- Consideration of how the performance of "pre-issuance" reviews and "post-issuance" reviews, and the results thereof, may factor into the firm's system of quality control; and
- The role and results of external reviews and how these interact with the internal monitoring system.

139. ISQC 1 could also require:

- Obtaining an understanding of the causal factors of audit deficiencies related to inspection findings and other reviews (such as EQC reviews, "pre-issuance" reviews, "post-issuance" reviews etc.) Obtaining an understanding of the causal factors of audit deficiencies would include consideration of information gathered at the engagement level regarding the audit deficiency.

⁸⁷ ISQC 1, paragraphs 48 and A64–A68

⁸⁸ ISQC 1, paragraphs 49–54 and A69

⁸⁹ ISQC 1, paragraphs 55–56 and A70–A72

- Policies and procedures to clarify the necessary actions regarding analysis of audit deficiencies and corrective measures may help prevent the circumstances giving rise to that deficiency from occurring on future engagements (e.g., policies and procedures to require that audit deficiencies should be subject to further analysis by a firm to obtain an understanding of why a deficiency occurred, and that corrective measures that should be designed, implemented and monitored to assess their effectiveness).

Any such changes to ISQC 1 may impact aspects of ISA 220 regarding whether understanding causal factors identified by the engagement team in conjunction with supervision and review activities may further positively impact audit quality.

140. Equally as important to understanding the causal factors of audit deficiencies related to inspection findings is monitoring by firm leadership of the effectiveness and appropriateness of the remedial actions. Monitoring by firm leadership might result in the need for new or improved responses to address the audit deficiencies identified, thereby continually improving the effectiveness of the system of quality control. In this regard, additional requirements or application material or clarifications of existing requirements and application material could be added to ISQC 1 to more explicitly articulate existing requirements and application material related to monitoring.
141. The use of a QMA by the firm would provide the opportunity to provide a stronger link to monitoring and remediation within the firm's system of quality control and further promote a focus on continuous improvements to quality.

Question

QC7. Which of the possible actions outlined in paragraphs 138-141, would be viewed as most meaningful to address issues related to promote a focus by firms on continuous improvements to quality? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you support the incorporation of a new requirement(s) in ISQC 1 for firms to understanding the causal factors of audit deficiencies relating to inspections findings and other reviews? If not, why not? Are there any potential consequences or other challenges of taking this action that you believe the IAASB needs to consider?
- (b) Do you agree with the inclusion of requirements in ISQC 1 for the results of the firm's monitoring of the effectiveness and appropriateness of the remedial actions to be considered in the design and assessment of the effectiveness of the firm's system of quality control? Please provide further detail to explain your response.

Engagement Partner Performance and Rewards Systems

ISSUES

142. The engagement partner performs a pivotal role in an audit and is responsible for the overall quality on each audit engagement to which the partner is assigned.⁹⁰ In the context of audit quality, some have suggested that it may be appropriate to provide that an element of a partner's remuneration should be variable and include incentives or sanctions more closely linked to whether audit quality has been achieved.
143. ISQC 1 does not include requirements or application material in respect of human resource policies governing fixed and variable remuneration for partners or remuneration based on the provision or cross selling of additional services beyond those contracted for.

SMP PERSPECTIVE

144. In the case of a sole practitioner or micro-firm that may have very few partners and perhaps only one or very few of those partners performing audits, inclusion of a requirement that a component of an audit partner's remuneration be linked to incentives related to achieving audit quality may be challenging to implement and may also have unintended consequences to SMPs.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

145. ISQC 1 does not have any requirements that address compensation – but rather addresses compensation in the context of other requirements. For example, application material regarding the importance in promoting an internal culture based on quality includes establishing policies and procedures that address compensation, including incentive systems and the assignment of responsibilities so that commercial considerations do not override the quality of the work performed.⁹¹
146. ISQC 1 includes compensation as a personnel issue relevant to the firm's policies and procedures related to human resources.⁹²
147. The IESBA Code includes compensation safeguards against a member of the audit team being compensated for selling non-assurance services to that audit client.⁹³ In addition, some jurisdictions have various rules and regulations regarding this topic.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

148. Similar to some governance frameworks, ISQC 1 could specifically require that firms, as part of their human resource policies and procedures, have a policy in place governing remuneration of partners and other key staff.
149. ISQC 1 could also seek to address linkage between compensation and audit quality. Acknowledging that audit quality is one of many factors that should be considered as part of a remuneration structure, and including examples in ISQC 1, such as describing factors that may address how inspection

⁹⁰ ISA 220, paragraph 8

⁹¹ ISQC 1, paragraphs A5 and A24–A25

⁹² ISQC 1, paragraph A24

⁹³ IESBA Code, paragraphs 290.225 and 290.226

findings (or lack thereof) relate to audit quality, may provide useful context on how the linkage between audit quality and compensation may be achieved.

150. Remuneration of partners and other key staff could include incentives to address audit quality, such as profit-sharing based on achieving audit quality or sanctions when audit quality is not achieved. Assessing audit quality could include consideration of the results of internal and external inspection of engagements, including the severity of any related findings.
151. However, the IAASB does not believe ISQC 1 should be used as a vehicle to mandate the structure of an engagement partner's remuneration, specifically with respect to compensation that may be withheld and paid out in the longer term based on the results of pre-determined criteria in the intervening period.
152. To achieve greater consistency with the spirit of the requirements in the IESBA Code,⁹⁴ ISQC 1 could also include new application material relating to threats related to the provision of non-assurance services to audit clients and safeguards needed with respect to related compensation.

Question

QC8. Do you believe it is necessary for the IAASB to create a link between compensation and quality in its standards? Why? If so, how can this best be done? Are there potential consequences of doing so that you believe the IAASB needs to consider?

Human Resources

ISSUES

153. The knowledge, skills and competence of a firm's employees and the manner in which those employees are assigned to an engagement are essential to achieving audit quality (and therefore would be an important consideration in the firm's determination of quality risks in establishing a QMA). Continuity planning (which typically encompasses loss of key employees, loss of an office, and the introduction of sanctions affecting key personnel or the firm and rotations) is an additional consideration that impacts the knowledge, skill and competency of the firm's employees.
154. Effective continuity planning involves developing and maintaining an appropriate structure for managing people within the firm that supports the firm's commitment to attracting, developing, motivating, retaining and rewarding personnel in line with the firm's strategy and quality objectives. However, financial considerations may undermine a firm's commitment and ability to effectively plan for continuity of appropriately experienced and trained staff. It is therefore important that firms are not unduly influenced by the need to meet target financial metrics, such that the firm's policies do not allow for appropriate investment in training and education of personnel or that result in insufficient partner hours being allocated to an engagement.

SMP PERSPECTIVE

155. SMPs have cited challenges in their ability to attract and retain appropriate talent, while acknowledging that this cannot be resolved through updates to auditing or quality control standards. A recent IAASB SMP Survey highlighted difficulties with the performance of staff reviews, with a view

⁹⁴ IESBA Code, paragraph 290.32

expressed that formal documentation of staff reviews may not be necessary in every case, such as when the engagement partner gives continual feedback to staff.

EXISTING REQUIREMENTS AND APPLICATION MATERIAL

156. ISQC 1 includes requirements and application material around personnel issues relevant to a firm's human resources policies and procedures.⁹⁵ For example, ISQC 1 notes that the personnel issues of career development and promotion are relevant to a firm's human resources policies and procedures, but does not provide detail as to what is envisaged.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

157. Clarification to the application material in ISQC 1 that financial considerations should not undermine quality objectives may be helpful. Additional application material to support the requirements addressing career development and promotion could highlight that part of career development and promotion is providing timely and informative performance appraisals and evaluations; however, how such evaluations are performed may be based on the facts and circumstances of the firm.

158. Continuity planning requirements may be an appropriate addition to ISQC 1, in particular in the context of the firm assessing the risks of not being able to meet its quality objectives, and what responses may be necessary considering the particular facts and circumstances.

Engagement Partner Competency

ISSUES

159. In order to properly fulfill their responsibilities in accordance with the ISAs, it is essential that engagement partners have the necessary skills and competence. ISQC 1 and ISA 220 do not contain detailed requirements or application material that specifically address the necessary skills and competence that engagement partners should have. The IAESB⁹⁶ recently issued IES 8 (Revised).⁹⁷ This standard focuses on the professional competence requirement for engagement partners who have responsibility for audits of financial statements. The standard is organized by areas of competence, including: Technical Competence; Professional Skills and Professional Values, Ethics and Attitudes. The considerations in these areas provide useful guidance, through the learning outcomes, as to the characteristics necessary for an engagement partner in fulfilling the responsibilities under the ISAs.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

160. IES 8 (Revised) notes that competence in Interpersonal and Communication Skills includes effective and appropriate communication with the engagement team, management and those charged with governance of the entity.⁹⁸

⁹⁵ ISQC 1, paragraphs 29–31 and A24–A26

⁹⁶ The International Education Standards (IESs) issued by the IAESB provide IFAC member bodies and stakeholders interested in accounting education with a common reference point or benchmark.

⁹⁷ IES 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)*

⁹⁸ IES 8 (Revised), Professional Skills (j) Interpersonal and communication

161. Paragraph A13 of ISA 220 notes that discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team. However, the concept of “more experienced team members” can be open to interpretation, as it is not defined in ISA 220.
162. In the area of Professional Skills, and specifically personal competencies, IES 8 (Revised) includes the promotion of and undertaking lifelong learning, acting as a role model to the engagement team and acting in a mentoring or coaching capacity to the engagement team.⁹⁹
163. Also within Professional Skills, IES 8 (Revised) notes the evaluation of whether the engagement team, including the auditor’s experts, collectively has the appropriate objectivity and competence to perform the audit, and the management of audit engagements by providing leadership and project management of engagement teams.¹⁰⁰ ISA 220 addresses the engagement partner’s responsibility to be satisfied that the engagement team has appropriate competence and capabilities.¹⁰¹
164. ISQC 1 includes that competence can be developed through coaching by more experienced staff, for example, other members of the engagement team.¹⁰²
165. ISA 220 currently requires that the engagement partner remain alert for non-compliance with relevant ethical requirements by members of the engagement team,¹⁰³ and subsequently explains that in paragraph A4 that the IESBA Code includes objectivity as one of its fundamental principles.
166. IES 8 (Revised), in the competence area of Professional Values, Ethics and Attitudes, highlights a commitment to the public interest, and more specifically, the promotion of audit quality in all activities with a focus on protecting the public interest.¹⁰⁴

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

167. The IAASB could undertake a more detailed review of the relationship between IES 8 and the standards (ISQC 1 and ISA 220) to determine whether greater attention can be given to the requirements in IES 8 by providing additional requirements or application material, or clarification to existing requirements and application material, including:
- Updating application material in ISA 220 to explain “more experienced team members,” and to emphasize the responsibility of the engagement partner for setting the appropriate tone for engagement team discussions such that all engagement team members feel comfortable raising questions.
 - Strengthening the requirements or enhancing the application material that discusses the responsibilities of the engagement partner in relation to relevant ethical requirements by members of the engagement team.
 - Updating application material in ISQC 1 or ISA 220 concerning the engagement partner responsibilities to include the concepts of leading by example and of mentoring.

⁹⁹ IES 8 (Revised), Professional Skills (k) Personal

¹⁰⁰ IES 8 (Revised), Professional Skills (l) Organizational

¹⁰¹ ISA 220, paragraph 14

¹⁰² ISQC 1, paragraph A25

¹⁰³ ISA 220, paragraph 9

¹⁰⁴ IES 8 (Revised), Professional Values, Ethics and Attitudes (m) Commitment to the Public Interest

- Updating requirements and application material in ISA 220 to make the engagement partner's responsibilities for leadership and project management (including the assessment of the competence and objectivity of the engagement team) more explicit.
- Considering whether ISQC 1 should explicitly highlight, the competencies in IES 8 (Revised) in the areas of Interpersonal and Communication Skills, Professional Skills and Professional Values, Ethics and Attitudes.

Question

QC9. Which of the possible actions outlined, or other actions not described, in **Human Resources** and **Engagement Partner Competencies** sections in paragraphs 157-158 and 167, would be viewed as most positively impacting audit quality:

- (a) Arising from issues related to knowledge, skills, competence and availability of a firm's partners and staff?
- (b) Related to engagement partner competencies?

Why do you believe these actions are necessary? Where you would not support a particular action, please explain why not, including any potential consequences of those actions that you believe the IAASB needs to consider.

Transparency Reporting

168. There is an increasing trend of firms issuing publicly available reports that provide transparency regarding certain elements of the firm and its operations, also referred to as transparency reports. This reporting is taking place either because it is required by law or regulation, or because firms are issuing such reports on a voluntary basis. However, current practices and the requirements for such reporting vary significantly between jurisdictions,¹⁰⁵ and may involve reporting on matters beyond the firm's system of quality control or other areas addressed by the IAASB's International Standards. Global organizations like the International Organization of Securities Commissions (IOSCO) are interested in the topic¹⁰⁶ and likely have the ability to influence a globally accepted form of, or requirements for, transparency reporting or common elements therein.

169. The IAASB believes it should seek to understand the demand and requirements for transparency reporting around the world, and how such reports are being used by investors, regulators and others. Doing so will enable the IAASB in understanding whether establishing requirements to address elements of transparency reporting – for example, requiring firms to provide greater insight into their

¹⁰⁵ Transparency reports are required in the European Union for firms that carry out statutory audit(s) of PIEs. These reports are required to include at least (i) information related to the legal structure and ownership of the firm; (ii) a description of the network the firm belongs to (if applicable); (iii) governance structure of the firm; (iv) a description of the firm's internal quality control system; (v) an indication of when the last quality assurance review took place; (vi) a list of PIEs for which the firm has carried out statutory audits during the preceding financial year; (vii) a statement regarding the firm's independence practices; (viii) the continuing professional education policy of auditors within the firm; (ix) firm financial information; and (x) information on basis for partner compensation. Transparency reports are also required or more commonly used in Australia, Japan and Turkey and are being considered elsewhere.

¹⁰⁶ In November 2015, IOSCO published a report on [Transparency of Firms that Audit Public Companies](#), which considers practices employed by audit firms and provides a Guide for transparency reporting.

system of quality control and its effectiveness – could be feasible on a global basis, and if so, how that might be done.

170. To date, the IAASB has discussed the following matters:

- (a) A number of jurisdictions already have national law or regulation that requires transparency reporting that includes information about the firm’s system of quality control. More consistent reporting of this nature across jurisdictions would likely be valuable to users of the reports and therefore in the public interest. However, in the absence of globally consistent transparency reporting requirements, it may be challenging or not feasible for the IAASB to set requirements or meaningful guidance addressing firm’s responsibilities for such reporting in an international standard. It may therefore be most appropriate for regulators and oversight bodies to establish specific transparency reporting requirements, as these can then be enforced and adapted at the jurisdictional level, and for NSS to develop the related requirements for auditors in those jurisdictions.
- (b) Transparency reporting is an area where practice is likely to continue to evolve to meet the needs of users of such reports. Trying to establish requirements related to firm transparency reporting could inhibit innovation in this area and possibly result in less useful information being provided to stakeholders, in particular if these reports are viewed as providing “boilerplate” information. However, the IAASB may be in a position to facilitate the evolution of transparency reporting in a positive way, for example through:
- Facilitating ongoing dialogue on the topic and encouraging academic research to explore the impact of transparency reporting on audit quality;
 - Issuing guidance to assist firms in describing their systems of quality control within the transparency reports required in their jurisdiction or that might be issued on a voluntary basis; and
 - Developing a thought piece or other non-authoritative material on the topic.

Questions

QC10. Do you believe the IAASB should undertake work in relation to transparency reporting? If so, what, in your view, would be the most appropriate action the IAASB could take at this time in light of the variations in law or regulation, as well as practice, with respect to transparency reporting? Where you would not support a particular action, please explain why not, including any potential consequences of those actions that you believe the IAASB needs to consider.

The following questions are overall questions relating to quality control:

QC11. Are there any other issues relating to quality control that the IAASB has not identified? If yes, please provide details, as well as views about actions that the IAASB should take to address them.

QC12. Are there any other specific actions that others could take to address the issues that have been set out in this section of the ITC? If yes, please provide details.

QC13. From the SMP perspective, are there any specific considerations related to the issues and potential actions described in this section of the ITC? Are there any other SMP considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the

related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

QC14. Are there any public sector considerations related to the issues and potential actions described in this section of the ITC, or any other public sector considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

Strengthening the Standards Addressing Group Audits

The feedback received by the IAASB in developing its [Work Plan for 2015–2016](#) indicated that there are issues and concerns in the following areas related to group audits:¹⁰⁷

In relation to the application of ISA 600 in particular circumstances—Matters relating to:

- “Letterbox audits”, i.e., whether ISA 600 applies in the situation where the group parent entity is registered in one jurisdiction, which is where the group auditor is based, but the group’s operations, accounting records and management are located in a different jurisdiction.
- The practical implications of applying ISA 600 in certain circumstances, such as when access to the relevant information is restricted (in particular when a significant component is an equity investment or joint venture) and in “funds of funds” structures.
- Whether and, if so, how ISA 600 applies in situations where shared service centers are used.

In relation to auditor performance in accordance with ISA 600—Concern has been expressed about:

- The extent of the group auditor’s involvement in the work of the component auditor (the amount and scope of work needed by the group auditor in relation to the component including the audit evidence needed, access to the workpapers of the component auditor, and clarification of various aspects relating to “significant components”);
- Communication between the group auditor and the component auditor;
- Application of the concept of component materiality;
- Identifying a component in complex situations; and
- Work effort of the component auditor.

Issues arising in the Quality Control and Professional Skepticism initiatives may also be relevant to this work.

The matters above present a summary of the initial input to the project on group audits as presented in the [IAASB’s Work Plan for 2015–2016](#). However, in exploring these matters further and based on the IAASB’s deliberations and input from its CAG and from outreach activities, the IAASB’s understanding of some of the issues has evolved, and in some cases the issues have been refined or expanded. The description of the matters in the discussion that follows reflects these refinements and expansions.

The IAASB believes that the issues set forth below represent those matters where priority attention may be needed to take action to respond to public interest calls to enhance audit quality in relation to group audits. The IAASB is particularly interested in further understanding stakeholders’ views about the issues affecting group audits and the possible actions that may be taken (including

¹⁰⁷ Input included the findings from the IAASB’s ISA Implementation Monitoring project, a stakeholder survey on work plan priorities, consultation on the proposed Work Plan for 2015–2016, and input from outreach with key stakeholders.

input on the IAASB's initial views about those actions). In particular, the IAASB is interested in understanding whether the issues have been overcome (e.g., because firms have developed internal guidance to address certain aspects of the issues) or whether practical challenges continue to be experienced and whether these are as described in the paragraphs that follow. The IAASB is also interested in hearing about actions related to group audits that may help emphasize professional skepticism or how the IAASB's possible actions might be enhanced to better emphasize and support the appropriate application of professional skepticism. In describing the issues and possible actions, the IAASB has not explicitly addressed changes to the definitions of terms that are already defined in the ISAs (including ISA 600). However, in making changes to the ISAs, it may be necessary to also revisit the relevant definitions to determine whether changes are needed.

The issues relating to group audits that are discussed below are organized as follows:

Strengthening and Clarifying How the ISAs, Including ISA 220, Apply in a Group Audit (See paragraphs 171–180)

Group Audit Specific Issues

- Acceptance and continuance of the group audit engagement (See paragraphs 181–194).
- Communications between the group engagement team and component auditors (see paragraphs 195–201).

Using the Work of the Component Auditors

- Issues relating to understanding the independence, competence and capabilities of the component auditors (See paragraphs 202–209).
- Issues relating to the group engagement team's involvement in the work of the component auditors (See paragraphs 210–216)

Identifying and Assessing the Risks of Material Misstatement in a Group Audit (Including Issues Relating to the Group Engagement Team's Involvement in the Consolidation Process)

- Issues relating to the group engagement team's understanding of the components and identifying significant risks for the group (See paragraphs 217–227).
- Issues related to component materiality and other aspects of materiality relevant to group audits (see paragraphs 228–235)

Responding to Identified Risks of Material Misstatement

- Issues related to audit procedures performed on the component's financial information (See paragraphs 236–247)
- Issues relating to situations where there are only non-significant components, or a large number of non-significant components (See paragraphs 248–253)
- Issues relating to the group engagement team's involvement in the consolidation process (See paragraphs 254–261)
- Issues relating to subsequent event procedures (See paragraphs 262–265)

Review and Evaluation of the Work of Component Auditors By the Group Engagement Team

- Issues relating to evaluating the communications from the component auditors and the adequacy of their work (See paragraphs 266–273)
 - Issues relating to the evaluation of the work of component auditors on the group engagement and whether sufficient appropriate audit evidence has been obtained (See paragraphs 274–277)
- Other Issues Relating to Group Audits
- The impact of new and revised auditing standards (See paragraph 278–279)

STRENGTHENING AND CLARIFYING HOW THE ISAs, INCLUDING ISA 220, APPLY IN A GROUP AUDIT

171. Many audits today are audits of group financial statements (group audits), which generally involve participation of component auditors¹⁰⁸ who perform work on financial information related to components that comprise the group. Component auditors may be part of the same firm or same network or group of affiliated firms as the group engagement partner and group engagement team, or they may be from unrelated firms. Different types of component auditors give rise to different considerations for the group engagement team in terms of developing plans to be sufficiently involved in the work of component auditors.
172. Group audits may be particularly influenced by factors that add to the complexities and challenges of performing such audits. For example, component auditors may operate in jurisdictions with different cultures and languages, law or regulation (which may impact access to necessary information or working papers, as well as different independence and ethical requirements), and financial reporting and auditing requirements.
173. As with any audit conducted in accordance with the ISAs, all relevant ISAs apply to group audits. ISA 600 deals with special considerations that apply to group audits, but specifically notes that the group engagement partner applies the requirements of ISA 220 regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial information of components.¹⁰⁹
174. The IAASB understands that the interaction of the requirements, definitions, and guidance in ISA 600 is viewed by some stakeholders as limiting the flexibility of the standard, and that questions arise as to how to most effectively apply the standard in certain circumstances. For example, a group auditor faces practical challenges in some cases, such as when determining the nature, timing and extent of the required involvement in the work of component auditors, in addressing matters such as an entity's use of shared service centers or in establishing expectations in relation to consolidations performed at the regional or segment level. None of these matters are expressly addressed in ISA 600. In addition, significant issues and concerns relating to group audits have been highlighted by regulators and audit oversight bodies, including concerns about interpretations as to when ISA 600

¹⁰⁸ A component auditor is an auditor who, at the request of the group engagement team, performs work on the financial information related to a component for the purpose of a group audit.

¹⁰⁹ ISA 600, paragraph 5

does or does not apply, as well as insufficient assessments by group engagement teams of risks of material misstatement and responses thereto.

175. In addition to the risk of material misstatement of the group financial statements, audit risk in a group audit also encompasses the possibility that a misstatement at the component level, or across components is not detected, which might result in the group financial statements being materially misstated. Issues may arise for a variety of reasons, including, for example, a component auditor failing to identify (or communicate to the group engagement team) a misstatement that could be material to the group either individually or when aggregated with other misstatements, or the group engagement team failing to evaluate the broader implications of a misstatement identified by a component at either the group level or for affected components.
176. It has been observed that scoping a group audit based on the identification of components (and identification of those that are significant) may not always result in an appropriate top-down approach to the assessment of the risks of material misstatement to the group financial statements and the planning and performance of appropriate responses to those risks. A further consequence of scoping based on the identification of components is that the work performed on the financial information may not always be appropriate or sufficient for the purposes of the group financial statements. For example, the requirement to perform an audit of financial information at significant components may not appropriately focus the work of a component auditor on those aspects that are likely to be most significant in relation to the group financial statements (i.e., when the risks of material misstatement related to the component's financial information are of varying levels of significance).
177. Given the importance of the identification and assessment of risks of material misstatement and the design of appropriate responses to achieving the outcome of a quality audit, the IAASB believes it is essential that the link in ISA 600 to the other ISAs that are most likely to always be relevant to the planning and performance of a group audit be sufficiently clear. In particular, the IAASB believes it is necessary to clarify, and potentially expand on, how the auditor is expected to apply the requirements in ISA 315 (Revised) and ISA 330¹¹⁰ related to the identification and assessment of the risks of material misstatement and responding to those risks. For example, the IAASB could expand on how these ISAs are to be applied in relation to a group audit, by emphasizing the challenges in assessing and responding to risks of material misstatement at the group level, how to drive the assessment of these risks to the component level and the need for two-way communication with component auditors about these identified risks, responses and outcomes of the component auditor's work. The IAASB may also find it necessary to develop new guidance or requirements for auditors who serve as component auditors, which may be particularly useful to SMPs who may often function in this capacity.
178. In considering necessary changes to the ISAs, the IAASB needs to take into account that group structures are not consistent, and that entities that appear to have similar structures will typically have unique characteristics. Variations in competence and expertise of component auditors will also exist. As such, ISA 600 cannot be overly prescriptive in setting forth the nature, timing and extent of appropriate involvement of the group engagement team in the work of component auditors, nor can ISA 600 be expected to address all the different approaches that might be appropriate. It is important that the principles-based nature of the ISAs be preserved with a view to them continuing to be "fit for purpose" as structures continue to evolve. In this way, the ability of the auditor to manage and

¹¹⁰ ISA 330, *The Auditor's Responses to Assessed Risks*

organize the audit engagement to respond to specific practical challenges related to the structure of the entity and related circumstances will be preserved. The IAASB believes that linking more clearly to important principles in other ISAs (e.g., relating to appropriate direction, supervision and review, and identifying and responding to identified risks of material misstatement) may better illustrate how ISA 600 would be expected to be applied or adapted in particular circumstances. In particular, the IAASB recognizes that a number of issues discussed in the context of its work on professional skepticism and quality control are likely relevant to the revision of ISA 600 – in particular, the group engagement partner’s responsibilities for the quality of the group audit.

179. As noted in paragraph 39, consideration is being given to whether ISQC 1 should be revised incorporate a QMA at the firm level. If ISQC 1 is revised in this manner and as revisions to ISA 600 are contemplated for the matters addressed in this ITC, consideration will also be given to the implications of a firm-level QMA for the engagement-level requirements and guidance in ISA 600.

180. The rest of the group audits section of this ITC sets out issues that have been identified, and possible actions that the IAASB may consider.

Questions

GA1. Specific issues have been noted in relation to group audits that suggest improvements to the ISAs are necessary. The IAASB is exploring how ISA 600 (and potentially other standards) may need to be revised to respond to those issues.

- (a) Do you believe that more specific emphasis on the application of all relevant ISAs in an audit of group financial statements in ISA 600 is appropriate and that it will help achieve the flexibility that is needed to allow for its application in a broader way, and to a wide range of circumstances (see paragraphs 171–179)? If not, please explain why and provide any additional actions you believe the IAASB could undertake to address issues set out in this consultation.
- (b) Do you believe the actions the IAASB is exploring in relation to the issues raised regarding ISA 600 would be meaningful and would improve the quality of group audits? If not, why not?

ACCEPTANCE AND CONTINUANCE OF THE GROUP AUDIT ENGAGEMENT

181. Audit engagements may only be accepted or continued when the engagement exhibits certain characteristics. In particular, the engagement partner needs to establish that certain preconditions, the responsibility for which rests with management and, where appropriate, those charged with governance, are present. These preconditions include obtaining agreement of management that it acknowledges and understands its responsibility to provide the auditor with:

- Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- Additional information that the auditor may request from management for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.¹¹¹

¹¹¹ ISA 210, paragraph 6(b)(iii)

In a group audit engagement, the group engagement partner needs to establish that these same preconditions are present before accepting or continuing with the engagement. If access to the required information or entity personnel is not, or will not be available, there is a presumption that the group audit engagement would not be accepted or continued.

182. When the group engagement partner makes a decision to accept a new group audit engagement, or continue with an existing engagement, ISA 600 also requires that in applying ISA 220, the group engagement partner is required to 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.¹¹² For this purpose, the group engagement team is required to obtain an understanding of the group, its components, and their environments sufficient to identify components that are likely to be significant components. Where component auditors will perform the work on the financial information of such components, the group engagement partner is required to 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.
183. Issues relating to the responsibilities of the engagement partner, and possible actions to address these issues, are set out in paragraphs 53–70. The effect on ISA 600 of any changes made in relation to ISA 220 in this regard will need to also be considered.

ISSUES

184. It has been noted in some inspection findings that there are situations where auditors give inadequate consideration to certain matters that may be relevant to the decision about whether to accept or continue a group audit engagement, and that the documentation of such considerations does not adequately reflect the decision making process. In this regard, some regulators and audit oversight bodies and others are concerned that group engagement partners, before accepting a new group audit engagement or making a decision to continue an existing engagement, do not obtain a sufficient understanding to be able to be satisfied that they can reasonably expect that sufficient appropriate audit evidence will be able to be obtained, Example of matters that may not be adequately considered, or appropriately documented, at the acceptance and continuation stage include:
- (a) The ability to access the information that may be required for the group audit, including access to people or information at the components (e.g., access to financial information of the component or to component management). Issues sometimes arise in situations where:
 - Group management may not have the ability to direct management of the component to cooperate with the group engagement team (e.g., when investments are accounted for in accordance with the equity method or when there are other non-controlled entities that are consolidated or included in the group financial statements);
 - Law or regulation, such as those around privacy and confidentiality, may prohibit access by the group engagement team to component management or to component auditors.
 - (b) The ability to be involved in the work of the component auditors to the extent necessary to obtain sufficient appropriate audit evidence, including the ability to:

¹¹² ISA 600, paragraph 12

- Effectively conduct two-way communication with the component auditors throughout the audit and, as considered necessary, have access to their working papers.
 - Be sufficiently involved in the work of the component auditors to be able to effectively take responsibility for the direction, supervision and performance of the group audit engagement, including the work of component auditors.
 - Issues also arise when information requested by the group engagement team from a component auditor is not readily available or typically shared outside the component auditor's firm (such as information about the results of internal or external quality reviews that the group engagement team may inquire about as part of a consideration of the competence and capabilities of the component auditors).
- (c) The impact on the group audit of “environmental” issues relating to the component entity (e.g., difficulties that may arise in being effectively involved in the work of component auditors and in obtaining sufficient appropriate audit evidence because of different cultures or customs where components of the group or component auditors are located and where group management and the group engagement team are. It may also be necessary to specifically consider the effect of threats to personal safety that may be present in jurisdictions where the component audit is located in determining whether to accept or continue an engagement (e.g., including the effects of war or other unrest or outbreaks of hazardous diseases).
- (d) The impact on the group audit of differing law or regulation relating to the entity and its components (e.g., where components prepare financial information using financial reporting standards that are different from the group financial reporting standards) and the group auditor and component auditors (e.g., differing relevant ethical requirements (including independence requirements)).
- (e) The impact on the group audit of complex group structures, including obtaining an understanding of the business rationale for the legal and operational structure of the group and its components.
185. It has also been noted that going forward, it will also be necessary for the group engagement partner to consider the impact of mandatory auditor rotation¹¹³ of one or more component auditors on the decision to continue the group audit.
186. Some regulators and audit oversight bodies have also expressed concerns that in circumstances where the engagement partner is not located where the majority of the audit work is performed,¹¹⁴ it is not always apparent that the engagement partner has been sufficiently involved in the process of deciding whether to accept or continue the engagement.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

187. ISQC 1 requires that firms establish policies and procedures for the acceptance and continuance of engagements, designed to provide the firm with reasonable assurance that the firm will only undertake work where the firm is:
- Competent to perform the engagement and has the capabilities, including the time and resources;
 - Can comply with the relevant ethical requirements; and

¹¹³ Some jurisdictions now require mandatory auditor rotation by law or regulation.

¹¹⁴ These situations are referred to by some as audits of “letterbox companies.”

- Has considered the integrity of the client.¹¹⁵

188. ISA 220 indicates that within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement. ISA 220 requires the engagement partner to be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed.¹¹⁶ The requirements of ISA 600 provide additional context to the application of ISA 220 in the context of a group audit engagement, including that the group engagement partner 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.

189. The application material in ISA 600 includes various examples of where the group engagement team may obtain the necessary understanding of the group, its components and their environments when accepting a new, or continuing with an existing, group audit engagement, what matters the understanding may include and how the ability to obtain sufficient appropriate audit evidence may be affected by significant changes.¹¹⁷

190. ISA 210 requires the auditor to establish that certain preconditions for an audit are present, including the acknowledgement and understanding from management, included in the terms of the engagement, that the auditor will be provided with access to all information that is relevant for the audit¹¹⁸ (see paragraph 181 above).

191. Paragraph 13 of ISA 600 addresses situations where the group engagement partner concludes that restricted access will impact the ability to obtain sufficient appropriate audit evidence to support the audit opinion. The requirements include that the group engagement partner should not accept a new engagement where there will be a scope limitation that would result in a disclaimer of opinion on the group financial statements (if the restrictions are imposed by group management), or, if possible under law or regulation, should withdraw from an engagement if it is concluded that it will not be possible to obtain sufficient appropriate audit evidence due to restrictions imposed by group management and the possible effect of this inability will result in a disclaimer of opinion on the financial statements.¹¹⁹ Paragraph 13 is supported by application material in paragraphs A14–A19 which covers both situations where the restrictions are imposed because of circumstance and where the component auditors refuse to provide access to relevant audit documentation sought by the group engagement team.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

192. In its discussions about possible responses to address the issues, the IAASB identified the following possible actions:

- (a) Strengthening the requirements in ISA 600 to drive earlier identification by auditors of those situations where there is:

¹¹⁵ ISQC 1, paragraph 26

¹¹⁶ ISA 220, paragraph 12

¹¹⁷ ISA 600, paragraphs A10–A12.

¹¹⁸ ISA 210, paragraph 6(b)(iii)

¹¹⁹ ISA 600, paragraph 13

- No reasonable way of obtaining sufficient appropriate audit evidence and clarifying what to do in such situations (i.e., not accept or continue the engagement, or making it clear to management and those charged with governance that the result will be a disclaimer of opinion so that management can take any actions considered necessary such as communicating with intended users of the financial statements); or
 - Likely to be significant complexity or difficulty in obtaining sufficient appropriate audit evidence.
- (b) In addition to strengthening the requirements, clarifying the existing application material in paragraphs A10–A12, or providing additional application material for matters that may need to be considered in obtaining an understanding of the group, its components and their environments, as well as the component auditors, i.e., to place the group engagement partner in the position of being able to make the decision to accept or continue the engagement on the most informed basis possible. The nature and extent of the understanding required to be obtained would however need to be explored further, especially as it relates to new engagements where it would be necessary to take into account that this understanding is obtained prior to the firm being engaged (i.e., natural limitations to the nature and extent of the understanding will therefore exist, including that the auditor will not be able to consider or leverage knowledge from prior audit engagements).
- (c) Strengthening the link in ISA 600 to the requirements in ISQC 1 that address the firm’s acceptance and continuance policies and procedures, and the requirements in ISA 220 that address the engagement partner’s related responsibilities for quality at the engagement level. Making these links more direct would reinforce the need for the group engagement partner to consider the competence and capabilities of the component auditors when considering the competence and capabilities of the collective engagement team performing the group audit engagement.¹²⁰
- (d) Emphasizing that the agreed terms of the engagement are expected to include that group management agree to the preconditions for the group audit, including agreeing to provide the auditor with access to all information relevant for the group audit (i.e., consistent with ISA 210). For example, application material could be added to explain what “access to information” means in the context of a group audit and the importance of considering what is relevant in the context of understanding the group, its components and their environments. In particular, application guidance may highlight the importance of considering the effects of complex structures, the existence of non-controlled components, or where law or regulation may restrict access to a component’s information. Furthermore, revisions to the standard could also help clarify and emphasize that access to relevant information is a necessary and important consideration in the acceptance or continuance process.
- (e) Providing more clarity about the different circumstances that may lead to access issues. Enhancing the application material for the specific circumstances that cause problems and providing some examples about how some of the issues may be overcome may help auditors address some known issues. The examples could draw from current practices that group

¹²⁰ ISA 220, paragraph A8 provides examples of matters to be considered in the acceptance and continuance of client relationships, including that the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources.

engagement teams or component auditors have used to overcome access issues (and the IAASB is interested in learning more about these). However, it is acknowledged that some of the issues related to access result from situations that revisions or clarifications to the standards will not be able to resolve.

- (f) Providing more specific considerations related to situations where the component auditors have policies and procedures that are different to those of the group engagement team (or are subject to different law or regulation and professional oversight, have different education and training backgrounds, are members of different professional organizations, use different standards or have different languages and culture). Additional guidance may include, for example, highlighting the need to consider whether and how such matters affect the group engagement team's ability to be adequately involved in the work of the component auditors (see also the discussion about the quality control aspects relating to networks of firms in paragraphs 91–100).

193. The IAASB has also considered whether the existing requirement in paragraph 12 of ISA 600 could be strengthened to clarify or more directly address that the determination about whether to accept or continue a group audit engagement is based on the group engagement partner's consideration as to whether sufficient appropriate audit evidence is expected to be able to be obtained. In particular, the requirement could be reworked to place greater emphasis on the need for an explicit conclusion as part of the acceptance or continuance decision, that the group engagement partner and group engagement team can fulfill their respective responsibilities relative to the engagement overall, including as they relate to taking responsibility for the direction, supervision and performance of the work done by component auditors.¹²¹ Such a conclusion could be based on the consideration of the work that the group engagement partner and group engagement team will perform directly, as well as on the consideration of their ability to be sufficiently involved in the work of component auditors. Guidance could be provided to emphasize the significance of the judgments involved in drawing this conclusion, including highlighting the importance of documenting the auditor's considerations. For example, guidance may suggest that the greater the proportion of the group's financial information that is audited by component auditors, the more important it may be for the group engagement team to have documentation that reflects the considerations about how to be sufficiently involved in the work of component auditors.

194. Strengthening the requirements and clarifying that an appropriately detailed understanding of the group, its components and their environments is required before deciding to accept or continue a group audit engagement could:

- (a) Better assist group engagement partners in making a more informed decision when determining whether or not to accept or continue the engagement.
- (b) Result in earlier identification of issues affecting the ability to obtain sufficient appropriate audit evidence.
- (c) Enhance auditor performance through focusing at an earlier stage on obtaining information that will be relevant to the planning and performance of the rest of the engagement.

¹²¹ The IAASB notes that the PCAOB's standards (PCAOB AU 543, *Part of Audit Performed by Other Independent Auditors*) explicitly require that the auditor decide whether he or she can serve as the principal auditor (i.e., the partner in charge of an audit of group financial statements).

Questions

GA2. Which of the possible actions outlined in paragraphs 192-194, would be viewed as most meaningful in addressing issues related to acceptance and continuance procedures? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Are access issues as described in paragraph 184(a) still frequently being experienced in practice? If yes, please provide details and where possible, explain how these are being addressed today.
- (b) Do you agree that ISA 600 can or should be strengthened in relation to addressing access issues as part of acceptance and continuance?
- (c) Do you have the view that expanding the understanding required for acceptance or continuance, as described in paragraph 192(b) above, would be achievable in the case of a new audit engagement?

COMMUNICATIONS BETWEEN THE GROUP ENGAGEMENT TEAM AND COMPONENT AUDITORS

195. Appropriate communications between the group engagement team and component auditors are an important element of a group audit, and in many ways, the foundation to the group engagement team's ability to be sufficiently involved in the work of component auditors. Communications between the group engagement team and the component auditors can take a variety of forms, including, but not limited to:

- (a) Team meetings (in-person or virtual), discussions and e-mail correspondence.
- (b) Group instructions provided by the group engagement team to component auditors.
- (c) Clearance memoranda or similar documents presenting component auditor's findings and provided by component auditors to the group engagement team.

ISSUES

196. Concerns have been expressed that the communication requirements in ISA 600, including those in paragraphs 40 and 41, are not specific enough to result in sufficient and appropriate communication between component auditors and the group engagement team during the planning and performance of a group audit engagement. Specific issues noted include:

- (a) Inadequate communication between the group engagement team and the component auditors during the audit, in particular as it relates to the communications related to the findings of the component auditor. Some stakeholders are looking for more of a 'feedback loop' in the required communications, 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.¹²²

- (b) The necessary communications are not taking place on a timely basis.
- (c) Group instructions provided by the group engagement team to component auditors may not be clear or appropriate. For example, the group engagement team may send standardized audit instructions to all component auditors and not tailor the instructions for each component auditor based on the applicable facts and circumstances and the work that each component auditor is being asked to perform. This issue is particularly relevant for SMPs who indicate that when they serving as component auditors for components that are not significant, they sometimes receive standardized instructions from group engagement teams that are designed for significant components and not tailored for the work that they are asked to perform on the non-significant components.
- (d) The communications back from the component auditor to the group engagement team may not be in the appropriate form for the group engagement team to be able to properly understand the information therein, and evaluate it as appropriate. The communications may not be in the same language as the group engagement team, may not contain sufficient detail (e.g., may be too summarized or may not adequately or clearly describe the work performed), may not contain the necessary findings resulting from the work or describe the conclusions of the component auditor in an appropriate manner.

197. When component auditors are required to express an opinion on the financial statements of a component, paragraph 48 of ISA 600 requires that the group engagement team request group management to inform component management of any matter that the group engagement team becomes aware of that may be relevant to the financial statements of the component, but which component management may be unaware. If group management refuses to communicate the information to component management, after discussing the matter with those charged with governance of the group, the auditor is required (subject to legal and professional confidentiality considerations) to consider advising the component auditor to not issue the report on the financial statements. Issues have been noted about the practical implications of applying this requirement in situations when the group engagement team is aware of non-compliance or suspected non-compliance with law or regulation that the group engagement team believes may be relevant to the financial information of the component (or the audit work being done by the component auditor). If group management or component management refuse to communicate the relevant information to the component auditor, or do not grant permission for the group engagement team to do so, the only possible communication for the group engagement team is to inform the component auditor not to issue the auditor's report on the component's financial statements. The requirement does not, therefore, provide for the ability of the group engagement team to communicate directly with the component auditor about the non-compliance, or suspected non-compliance, with laws or regulations that may be relevant to the audit of the financial statements of the component's financial statements or the audit work being performed on the component's financial information in accordance with the group instructions.

¹²² Further discussion about the group engagement's team's response to the findings of the component auditor is discussed in paragraphs 266–277

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

198. One of the objectives of a group engagement team is to communicate clearly with the component auditors about the scope and timing of their work on financial information related to the component and their findings.¹²³ ISA 600 sets out requirements about the necessary communications to achieve this objective, including the work to be performed, the use to be made of that work, and the form and content of the component auditor's communications with the group engagement team.¹²⁴ ISA 600 also sets out matters that the group engagement team should request the component auditor to communicate with regard to the group audit.¹²⁵

199. The communication requirements in ISA 600 were designed to allow for flexibility, based on the many variations in the way group audits are carried out and are therefore purposely not overly prescriptive. The related application material specifically explains that communications may not necessarily always be in writing, but are still required to take place on a timely basis.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

200. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- (a) Strengthening the requirements regarding communications between group engagement teams and component auditors, including placing more emphasis on the need for sufficient, appropriate and timely two-way communication during the audit and highlighting the importance of in-person or telephonic dialog to supplement more formal written instructions and other communications. Additional emphasis or clarity may help the group engagement team better understand the nature, timing and extent of communications with the component auditor that may be necessary and appropriate throughout the engagement. Enhanced requirements and more guidance may also help the group engagement team in better understanding whether instructions provided to the component auditors have been fully understood and complied with, and also in determining that what work is done and what is communicated by component auditors is consistent with the group engagement team's requests and expectations.
- (b) As it relates to the possibility of developing more specific requirements and guidance directed at component auditors (see paragraph 239 for further discussion), consideration could also be given to more clearly explaining and setting forth the requirements for the component auditor in making and participating in communications to the group engagement team. For example, there could be an emphasis on the need for sufficient, appropriate and timely two-way communication, including the need for component auditors to determine that there is a sufficiently clear and mutual understanding of the group engagement team's instructions. It could also be made clear that component auditors have a responsibility to bring relevant issues relating to the performance of their work on a component's financial information to the group engagement team in a timely and comprehensive manner.
- (c) Enhancing the supporting application material by explaining in more detail what the requirements are intended to achieve. For example, ISA 600 requires timely communication between the group

¹²³ ISA 600, paragraph 8(b)(i)

¹²⁴ ISA 600, paragraph 40–41

¹²⁵ ISA 600, paragraph 41

engagement team and the component auditors, but does not explain what is meant by timely. There is guidance in ISA 260 that addresses the timing of communications to those charged with governance which could be used as a basis to provide further explanation about timely communications in the context of ISA 600. Enhanced application material could also include examples of different kinds of communications that may be appropriate in different circumstances.

- (d) Adding application material to emphasize the importance of applying the requirements of ISA 230 in documenting significant communications between the group engagement team and component auditors (including two-way dialog), and not just focusing on the inclusion of written communications in the audit documentation.
- (e) Consideration of whether the requirements of paragraph 48, or the related application material, need to be revised to better address the ability of the group engagement team to communicate directly with a component auditor or component management when the group engagement team is aware of non-compliance or suspected non-compliance with law or regulation that may be relevant to the work being done by the component auditor.

201. Revisions to the communication requirements in ISA 600 may also improve the group engagement team's involvement in the work of component auditors (including understanding of the component auditors' findings); thereby providing an improved basis for the evaluation by the group engagement partner of the sufficiency and appropriateness of the audit evidence obtained for purposes of the group audit opinion.

Questions

GA3. Which of the possible actions outlined in paragraph 200, would be viewed as most meaningful in addressing issues related to communication between the group engagement team and the component auditor? Why do you believe these actions are necessary? Are there other relevant issues or actions that would be more meaningful and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further.

USING THE WORK OF THE COMPONENT AUDITORS

Issues Relating to Understanding the Independence, Competence and Capabilities of the Component Auditors

202. The group engagement team obtains an understanding of the component auditor when it plans to request the component auditor to perform work on the financial information of the component. This understanding will help the group engagement team determine whether, and to what extent, it can use the work of the component auditor. The group engagement team is still responsible for obtaining sufficient appropriate evidence upon which to base the opinion on the group financial statements. If the group engagement team determines that the work of a component auditor cannot be used, it will need to obtain the necessary audit evidence directly and without using the work of that component auditor. Alternatively, the group engagement team may identify another more suitable component auditor, and use the work of that component auditor. In the event that the group engagement team cannot identify a suitable component auditor and cannot otherwise obtain the necessary audit

evidence, it may not be appropriate to agree to accept or continue the engagement. If the acceptance or continuance decision has already been made, it will be necessary to consider whether to withdraw (unless precluded by law or regulation) and if not, the effect on the auditor's report.

ISSUES

203. Concern has been expressed about whether, and how, a group engagement team demonstrates the necessary understanding of the component auditor required by paragraph 19 of ISA 600, and the consequential impact on the group engagement team's determination of the nature, timing and extent of its involvement in the work of the component auditors. Concerns have been noted in situations where the group engagement team and component auditor are subject to common policies and procedures for performing the work (for example, using a common audit methodology), common quality control policies and procedures, or common monitoring policies and procedures (which are further discussed in paragraphs 91-100) as well as in situations when they are not.

204. As noted previously, there are new and continuing challenges in group audits as group structures become more complex and continue to evolve. Some of these challenges manifest themselves in particular when the group engagement team commences its work to obtain an understanding of the competence and capabilities of component auditors who are situated in a jurisdiction that:

- (a) Does not have similar legal and regulatory requirements as those that are applicable to the jurisdiction where the group engagement team is located,
- (b) Has different:
 - Oversight regimes.
 - Independence and ethical requirements.
 - Languages or cultures.
 - Licensing or accreditation requirements.

The group engagement team may have difficulty obtaining all relevant information considered necessary in order to properly understand the component auditors, including assessing their competence and capabilities. For example, there may be privacy laws or regulations in the jurisdiction of the component auditor that preclude certain information from being shared with the group engagement team, or the risk management policies of a component auditor's firm may not allow sharing of certain information with the group engagement team.

205. Concern has also been expressed about the group engagement team's understanding of the planned use of experts by component auditors when obtaining an understanding about the competence and capabilities of the component auditor, including challenging situations where there is no planned involvement of experts where their involvement would seem appropriate. For example, the tax laws and regulations in a particular jurisdiction may be particularly complex, and therefore, in understanding the competence and capabilities of the component auditor, it may be appropriate or necessary for the group engagement team to understand whether the component auditor plans to involve a tax expert with the necessary skills and who possesses relevant knowledge in that field of expertise, and if not, challenge the component auditor as to why not.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

206. ISA 600 requires the group engagement team to obtain an understanding of matters relevant to:

- Compliance with ethical and independence¹²⁶ requirements by the component auditors.
- The component auditors' professional competence.
- The ability of the group engagement team to be involved in the work of the component auditors so that sufficient appropriate audit evidence can be obtained.
- The regulatory environment in which the component auditors operates, in particular whether this environment actively oversees auditors.¹²⁷

207. ISA 600 precludes the group engagement team from being able to use the work of component auditors that do not meet the independence requirements relevant to the group audit, or in situations where the group engagement team has serious concerns about matters related to competence. Paragraphs A39–A41 provide additional guidance for the group engagement team, including examples about how less serious concerns about competence may be addressed. Additional guidance about independence considerations is provided in the application guidance to ISA 700.¹²⁸

208. ISA 220 sets out matters that may be considered when considering the appropriate competence and capabilities expected of the engagement team as a whole.¹²⁹ Given the interaction between ISA 220 and ISA 600,¹³⁰ this consideration extends to component auditors, and the introduction to ISA 600 therefore notes that the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities.¹³¹ ISA 600 also indicates that the nature, timing and extent of the group engagement team's procedures to obtain an understanding of the component auditors are affected by factors such as the previous experience with, or knowledge of, the component auditor, and the degree to which the group engagement team and component auditor are subject to common policies and procedures. ISA 600 provides examples of such factors, including noting the relevance of considering the consistency or similarity of laws and regulations, professional oversight, education and training, professional organizations and standards and language and culture. ISA 600 notes that different considerations and extent of procedures to obtain the necessary understanding might apply to different component auditors.¹³² ISA 600 and ISA 700 (Revised) also contain guidance about

¹²⁶ ISA 700 (Revised) 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.

¹²⁷ ISA 600, paragraph 19

¹²⁸ ISA 700 (Revised) paragraph A34 notes that "The ISAs do not establish specific independence or ethical requirements for auditors, including component auditors, and thus do not extend, or otherwise override, the independence requirements of the IESBA Code or other ethical requirements to which the group engagement team is subject, nor do the ISAs require that the component auditor in all cases to be subject to the same specific independence requirements that are applicable to the group engagement team. As a result, relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex."

¹²⁹ ISA 220, paragraph A11

¹³⁰ ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial information of components (ISA 600, paragraph 5).

¹³¹ ISA 600, paragraph 4

¹³² ISA 600, paragraphs A33 and A34

ethical requirements that are relevant to a group audit,¹³³ and understanding of the professional competence of the component auditors.¹³⁴

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

209. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- (a) Including an objective or strengthening the requirements in ISA 600 to clarify that the group engagement team should, make an explicit determination about whether it is appropriate to use the work of a component auditor, (i.e., based on the group engagement team's understanding of the component auditor and the nature and extent of the work the component auditor will be requested to perform.)
- (b) Enhancing, clarifying or expanding the application material in paragraph A33 of ISA 600 about the factors that are relevant to the group engagement team's procedures to obtain an understanding of the component auditor (e.g., through placing greater focus or specificity on the factors in the requirements or including additional application material to better support the requirements).
- (c) Enhancing the application material by including more specific examples that address some of the practical challenges that have been identified related to understanding the component auditors' compliance with relevant ethical requirements (including, independence), and their competence and capabilities.
- (d) Developing additional application material to address the impact on the understanding of the competence of the component auditors if there are different or no national or jurisdictional licensing requirements.
- (e) Enhancing the application material to more clearly address how group engagement teams can consider the existence of common policies and procedures or lack thereof in understanding component auditors and in determining the necessary levels of involvement by the group engagement team in their work. Such guidance would also need to address that the group engagement team's consideration would be expected to take into account other relevant factors (e.g., the consistency or similarity of laws and regulations, professional oversight, education and training, professional organizations and standards, and language and culture). In addition, application material could be developed on the need for understanding and how to use quality control monitoring results or the results of external quality reviews for component auditors, irrespective of whether the group engagement team and the component auditors are subject to common quality control monitoring mechanisms (see further related discussion in paragraphs 99-100).

Issues Relating to the Group Engagement Team's Involvement in the Work of the Component Auditors

210. As discussed in paragraphs 53–70, the group engagement partner takes responsibility for direction, supervision and performance of the group audit engagement.¹³⁵ When component auditors are

¹³³ ISA 600, paragraph A37

¹³⁴ ISA 600, paragraph A38

¹³⁵ ISA 600, paragraph 11

involved in performing work on the financial information of components, and the group engagement team will be using this work in determining whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion, the ISA requires that the group engagement team is able to be involved in the audit work of the component auditors to the extent necessary to obtain sufficient appropriate audit evidence. In finalizing ISA 600 as part of the IAASB's clarity project, the IAASB agreed that the requirement for the group engagement team to be involved in the work of the component auditor should be retained, but allowed flexibility for the group engagement team to determine the appropriate nature, timing and extent of such involvement based on the circumstances.

211. The group engagement team's involvement in the work of the component auditors depends on a number of interrelated factors and judgments, such as the competence and capability of the component auditor, the expected communications between the group engagement team and the component auditors, the identification of significant components and the determination of the necessary work relating to non-significant components. The appropriate nature, timing and extent of the involvement of component auditors will therefore vary according to the circumstances of each group audit engagement (e.g., considering the significance of the components, the significance of the risks of material misstatement related to the components and the results of the understanding of the component auditors), but it must be to the extent necessary to obtain sufficient appropriate audit evidence in order to form the basis for the opinion on the group financial statements.

ISSUES

212. Some regulators and audit oversight authorities have raised concerns that involvement of the group engagement team in the work of the component auditors is not always adequate, and that these concerns are particularly relevant in instances where the engagement partner is not located where the majority of the audit work is performed. For example, it has been noted in inspection reports by some regulators and audit oversight bodies that the nature and extent to which the group engagement team specifies or communicates identified risks of material misstatement or expected responses to component auditors varies, resulting in different levels of understanding and potentially different responses at the component level.
213. In addition, certain audit inspection reports have noted that the judgments around the nature, timing and extent of the group engagement team's involvement in the work performed by component auditors, and the reasons therefore, are not always clearly demonstrated (including the documentation by the group engagement team of the relevant considerations supporting its conclusions).

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

214. The group engagement partner is responsible for the group audit engagement. Where component auditors will perform work on the financial information of components, as part of the acceptance and continuance of the engagement, the group engagement partner is required to evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to determine whether the evidence obtained is sufficient and appropriate in the circumstances and that it will support the conclusions reached.¹³⁶

¹³⁶ ISA 600, paragraph 12

215. ISA 600 requires the group engagement team to determine the type of work to be performed on the financial information of the components (by the group engagement team or by component auditors on its behalf, and to determine the nature, timing and extent of its involvement in the work of the component auditors.¹³⁷ For significant components, there is a requirement for the group engagement team to be involved in the component auditor's risk assessment process to identify significant risks of material misstatement of the group financial statements.¹³⁸ ISA 600 specifically requires documentation of the type of work to be performed on the financial information of components¹³⁹ and the nature, timing and extent of the group engagement team's involvement in the work of the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditor's audit documentation and conclusions thereon.¹⁴⁰ Guidance about factors¹⁴¹ that may affect the group engagement team's involvement in the work of the component auditor, as well as examples of forms of involvement,¹⁴² are included in the application material in ISA 600.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

216. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- (a) Strengthening ISA 600 to provide more clarity as to how the group engagement team determines the nature, timing and extent of the necessary involvement in the work of the component auditors, including more explicit focus on demonstrating why the involvement of the group engagement team is appropriate in light of all relevant considerations. However, due to widely varying group structures and variations in component auditors (including as it relates to their competence and expertise), ISA 600 cannot be overly prescriptive in setting forth the nature, timing and extent of appropriate involvement of the group engagement team in the work of component auditors, nor can ISA 600 be expected to address all the different approaches that might be appropriate. For example:
- In some cases, it may be appropriate for a group engagement team to undertake site visits to meet with the component auditors and review their working papers in order to be appropriately involved in their work and effectively evaluate their findings.
 - In other circumstances, preparing group instructions and providing them to a component auditor, obtaining a memorandum from the component auditor that describes in sufficient detail the work performed based on the instructions, and the resulting findings and conclusions, may be sufficient for the group engagement team's purposes.

¹³⁷ ISA 600, paragraph 24

¹³⁸ ISA 600, paragraph 30

¹³⁹ ISA 600, paragraph 50(a)

¹⁴⁰ ISA 600, paragraph 50(b)

¹⁴¹ ISA 600, paragraph A54; see also the connection between A54 (c) and A33.

¹⁴² ISA 600, paragraph A55

- (b) Strengthening ISA 600, either through clarification or additions to the requirements or application material, as follows:
- Emphasizing the need for greater focus by the group engagement team on the significant judgments that need to be made about the nature, timing and extent of the involvement of the group engagement team in work performed by the component auditors, and the need for appropriate documentation thereof.¹⁴³
 - Clarifying the interrelationships between paragraphs 24, 30, A33, A47 and A54, of ISA 600 to assist auditors in better applying professional judgment in determining the nature, timing and extent of their involvement in the work of the component auditors.
 - More explicitly explaining the interactions between the group engagement team and the component auditors in varying circumstances (e.g., in different group structures or in jurisdictions where restrictions on access exist).
- (c) Providing further examples in the application material to illustrate the wide variety of circumstances that may affect the determination of the necessary nature, timing and extent of the group engagement team's involvement in the work of the component auditor. Additional examples may help distinguish the varying levels of involvement of the group engagement team that may be appropriate in different circumstances. These examples may address situations where:
- The component auditors and group engagement team are not subject to common policies and procedures.
 - The component auditors are from different jurisdictions, or are subject to dissimilar laws or regulations.
 - The professional oversight; discipline and external quality assurance; education and training; and professional organizations and standards differ between the component auditor and the group engagement team.
 - The language and culture of the component auditor are different to the group engagement team.

For example, the nature of the group engagement team's involvement in the work performed by the component auditor when they are not subject to the same policies and procedures (or where there are differences in any of the previously mentioned factors) will likely need to be different, and the nature and timing of such involvement may also need to be different. Depending on the circumstances, more detailed instructions and more frequent communications between the group engagement team and component auditors may be necessary as the audit progresses.

¹⁴³ ISA 230, paragraphs 8(c) and A8 sets out the documentation requirements for the significant professional judgments of the auditor in reaching their conclusions

Question

GA4. Which of the possible actions outlined in paragraph 216, would be viewed as most meaningful in addressing issues related to using the work of the component auditor? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you agree that the nature, timing and extent of involvement of the group engagement team in the work of the component auditor should vary depending on the circumstances? How, in your view, could changes to the standard best achieve this objective?
- (b) Do you agree that the standard should be strengthened to require the group engagement partner or team to make an explicit determination about whether the group engagement team can use the work of a potential component auditor?

IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT IN A GROUP AUDIT (INCLUDING ISSUES RELATING TO THE GROUP ENGAGEMENT TEAM'S INVOLVEMENT IN THE CONSOLIDATION PROCESS)

Issues Relating to the Group Engagement Team's Understanding of the Components and Identifying Significant Risks for the Group

217. The group engagement team is required to identify and assess the risks of material misstatement in the group audit through obtaining an understanding of the entity and its environment (including its internal control).¹⁴⁴ This understanding builds upon the understanding that has been obtained when deciding to accept (or continue) a group audit engagement (and as discussed in paragraphs 181–194).

ISSUES

218. It has been suggested that more clarity is needed about certain aspects of the understanding the group engagement team is required to obtain about the group, and its environment, in order to be able to appropriately identify and assess the risks of material misstatement for the group engagement, including significant risks. For example, some stakeholders have the view that the understanding of the components and their respective environments that is obtained by the group engagement team is, in some cases, not sufficient to be able to appropriately direct the attention of the group engagement team and component auditors towards the relevant risks of material misstatement that may exist in the group. Challenges identified include being able to appropriately understand and respond to the impact of:

- (a) Issues in multi-jurisdictional audits related to diverse markets and differing cultures.
- (b) Circumstances where the group structures are such that the engagement partner may be located in the jurisdiction of registration or listing of the entity, with the majority of the audit work being

¹⁴⁴ ISA 600, paragraph 17

performed in another jurisdiction where general and financial management are located, and where the business activities and related processing of transactions take place.

- (c) Overly complex or unusual group structures.
- (d) Evolving group structures that are becoming more complex, making the identification of components, and how to audit the related financial information, more difficult. For example, many entities are increasingly operating in integrated structures, such as situations where the transactions for the group are processed centrally (e.g., through a SSC). It has been noted that it is not clear in the ISAs how ISA 600 applies (or if it applies) to these situations. In some circumstances the SSC may be treated as a separately identifiable component. In other circumstances a SSC may not be considered a separate component based on applying the definition of component as stated in ISA 600. In some cases, the group engagement team might perform the work at a SSC, but in other cases, another auditor may be involved, but the IAASB notes that some confusion exists as to whether or not the involvement of such an auditor is to be considered and treated similar to that of a component auditor.

219. Related to the identification of significant risks, concern has also been expressed that:

- (a) Risks identified at the component level by the component auditors are sometimes not appropriately considered at the group level (i.e., inappropriate consideration is given as to whether such risks are group-wide risks or whether such risks also exist at some or all of the other components).
- (b) In situations where group-wide significant risks have been identified that relate to all components, including non-significant components where no procedures are planned to be performed, it may be confusing as to where or to which component the work related to the significant risk is to be directed in order to appropriately respond to the risk.
- (c) There is confusion about the interaction of ‘significant risks’ and ‘significant components’¹⁴⁵, and it has been noted that there are challenges in dealing with how the identification of significant risks at a component impacts the determination as to whether a component is a significant component. Significant components are identified either based on financial metrics or whether components are likely to include significant risks (determined in accordance with ISA 315 (Revised)). As identification and assessment of significant risks is also linked to the identification of significant components, it has been noted that ISA 600 does not provide much detail as to how significant risks that are pervasive to the group (and therefore exist at potentially all components) are to be taken into account in the determination as to which component are to be considered significant.

220. Lastly, in identifying a ‘significant component,’ it has been noted that some uncertainty exists as to what it means to be “of individual financial significance.”¹⁴⁶

¹⁴⁵ A ‘significant component’ is described as a component that is of individual financial significance to the group, or that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement in the group financial statements (ISA 600, paragraph 9(m))

¹⁴⁶ ISA 600, paragraph A5 provides guidance on identifying components of individual significance, including applying percentages to chosen benchmarks.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

221. Although certain aspects of the required understanding of the entity and its environment, and its internal control are not specifically covered in ISA 600 (e.g., relevant industry, regulatory, and other external factors including the applicable financial reporting framework), the requirement in paragraph 17(a) (as well as related application material in paragraphs A23–A29), should be applied when obtaining such understanding. Paragraph 18 and the related application guidance in paragraphs A30–31 address obtaining an understanding that is sufficient to confirm or revise the initial components that are likely to be significant and to assess the risks of material misstatement of the group financial statements.
222. Significant components are identified to help the group engagement partner and group engagement team determine the type of work to be performed on the financial information of components. The definition of a significant component in ISA 600 and the requirement to determine significant components drives the types of audit procedures to be performed.¹⁴⁷ The requirements are supplemented by application material about appropriate procedures in different circumstances.¹⁴⁸
223. The requirements for identifying significant risks in an audit engagement are contained in paragraphs 27–29 of ISA 315 (Revised), with related application material in paragraphs A132–A136. Although there are no specific requirements or guidance in ISA 600 for identifying significant risks, the group engagement team would be expected to refer to ISA 315 (Revised) in this regard in the context of the group audit engagement.
224. ISA 330 requires that if the auditor has identified a risk as significant, substantive procedures that are specific to that risk be performed.¹⁴⁹ ISA 315 (Revised) also requires that if the auditor has determined a risk to be a significant risk, the auditor is required to obtain an understanding of the relevant controls, including control activities.¹⁵⁰ Additionally, if the auditor's plans for further audit procedures include relying on controls over a significant risk, ISA 330 requires that the auditor test those controls in the current period (i.e., as opposed to using evidence from prior audits as the basis for the conclusion about their operating effectiveness).¹⁵¹

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

225. The requirements in ISA 600 and the related application material (as set out in paragraph 221 above), as well as the overarching requirement in paragraphs 11(a) and A26 of ISA 315 (Revised) would adequately, in the view of the IAASB, require auditors of group financial statements to obtain the necessary understanding of the entity and its environment in order to identify and assess the risks of material misstatement at both the group and component level.
226. However, the IAASB recognizes that improvements are likely needed to ISA 600 to make more explicit reference to the principles, requirements and related application material in ISA 315 (Revised) (related to identifying and assessing risks of material misstatement) and in ISA 330 (related to responding to those assessed risks), so as to better support application of those ISAs in group audit

¹⁴⁷ ISA 600, paragraphs 26–27

¹⁴⁸ ISA 600, paragraphs A48–A49

¹⁴⁹ ISA 330, paragraph 21

¹⁵⁰ ISA 315 (Revised), paragraph 29

¹⁵¹ ISA 330, paragraph 15

engagements. As discussed in paragraphs 171-179, the IAASB is considering making the links to the other ISAs more prominent in ISA 600. In particular, the IAASB also recognizes the need to acknowledge the existence of evolving environments and increasingly complex group structures, and to the extent possible, eliminate constraints that may exist or arise in relation to overly prescriptive definitions or interpretations of such definitions in the context of group audit engagements.

227. In addition, in its discussion about responses to address the issues, the IAASB identified the following further possible actions:

- (a) Providing additional examples for relevant aspects and principles in ISA 315 (Revised) and ISA 330 that may arise from a group audit (e.g., to address the examples where issues have arisen in paragraph 218 above). These changes may help reinforce that the understanding of the group and its components builds upon the requirements in ISA 315 (Revised), and the responses to the assessed risks of material misstatement are to be framed in terms of ISA 330, and may therefore help the group engagement team in better considering all aspects of where such risks may exist in a group audit, and in how those risks should be responded to, including at the component level.
- (b) 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 by the group engagement team to determine whether those risks 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 significant risk, but the facts and circumstances would appear to be the same or similar) or for the group overall.
- (c) Providing further clarification as to how significant risks that are pervasive to the group (and therefore exist at all components) impact the determination as to whether a component is to be considered significant would be beneficial.
- (d) Developing additional application material to further clarify the meaning of the phrase “of financial significance to the group,” as this may also help address some of the challenges in identifying significant components.

Issues Relating to Component Materiality and Other Aspects of Materiality Relevant to Group Audits

228. It has been noted that there is confusion and significant variation in practice as it relates to the understanding of the concepts of component materiality and component performance materiality, and their purpose, as well as the manner in which they are determined. For example, practical challenges arise where the component is a non-controlled entity (e.g., may be accounted for using the equity method of accounting) and the entity is larger than the investor entity such that the materiality and performance materiality for a standalone audit of that component would be larger than group materiality and group performance materiality. It has been noted that ISA 600 does not contain any guidance to address this situation.

229. It has also been noted that generally, the concept of aggregation risk that underpins the requirements and application guidance in ISA 600¹⁵² is also not well understood. Regulators and audit oversight bodies have noted instances where component materiality has been established at

¹⁵² The aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated.

levels equivalent to or only marginally below group materiality. Additionally, situations have been identified where the clearly trivial threshold at components exceeds that established at the group level.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

230. ISA 600 requires the group engagement team to determine:

- Materiality for the group financial statements as a whole when establishing the overall group audit strategy.
- As necessary in the specific circumstances of the group, lower levels of materiality for classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements as a whole.
- Component materiality for those components where component auditors will perform an audit or review for purposes of the group audit (and which is required to be less than group component materiality).
- The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.¹⁵³

231. In addition, where the component auditors will perform an audit for the purpose of the group audit, the group engagement team is required to evaluate the appropriateness of performance materiality determined at the component level (which may be accomplished by the group engagement team either establishing component performance materiality, or evaluating component performance materiality determined by the component auditor).¹⁵⁴

232. If a component has been or will be audited on a standalone basis (e.g., for statutory or regulatory purposes) and the group engagement team decides to use that audit to provide audit evidence for the group audit, the group engagement team is required to determine whether the materiality used in the audit of the component financial statements as a whole, and the related performance materiality for the component, comply with the requirements of ISA 600.¹⁵⁵

233. ISA 600 requires that component materiality be set at a level lower than materiality for the financial statements as a whole.¹⁵⁶

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

234. Many of the issues related to component materiality are intrinsically linked to the requirements and guidance in ISA 320,¹⁵⁷ and therefore cannot be narrowly addressed in the context of a project that is addressing ISA 600 more broadly. In its recently completed 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

¹⁵³ ISA 600, paragraphs 21 and A42–A45

¹⁵⁴ ISA 600, paragraph 22 and A46

¹⁵⁵ ISA 600, paragraph 23

¹⁵⁶ ISA 600, paragraph 21 (c) and A43

¹⁵⁷ ISA 320, *Materiality in Planning and Performing an Audit*

to monitor the IASB's developments, and in conjunction with its planned consultation on the Work Plan for 2017–2018, will obtain input to inform the determination as to the need for a future project to address materiality more broadly, including a possible review of ISA 320 in its entirety.¹⁵⁸ The IAASB will also continue to monitor relevant research on the topic. Therefore, the IAASB does not believe that any of its actions as part of the group audit project should pre-judge the outcomes of those efforts.

235. The IAASB is however open to the possibility of developing more topic-specific guidance relating to component materiality and other aspects of materiality relevant to group audits, as well as challenging whether any amendments to the requirements in ISA 600 are necessary. However, any actions taken should not infringe on the basic principles in ISA 320, in advance of a possible project involving an overall review of that standard as explained above. Examples of matters that the IAASB could consider in the context of its group audits project include:

- (a) More guidance about how the concepts of component materiality and component performance materiality and their relevance in a group audit are expected to be applied, recognizing that all groups and their components are likely subject to unique facts and circumstances and that such guidance will need to retain the principles based nature of the existing ISAs.
- (b) Further consideration of matters that are specifically relevant to component materiality, component performance materiality and component clearly trivial thresholds in the context of group audits, particularly in relation to the concept of aggregation risk, and consideration as to how these concepts might be made more clear and operational. Matters to address may include consideration as to whether:
 - The requirements in ISA 600 should be revised to indicate that component performance materiality and component clearly trivial thresholds should be less than the corresponding amounts at the group level; and
 - Additional guidance should be provided to further emphasize the requirements and provide additional context.
- (c) How materiality is to be applied in situations when procedures other than audits of financial information of components are being performed (e.g., when performing audits of one or more account balances, classes of transactions or disclosures or when performing specified audit procedures in terms of paragraphs 27(b) and (c) of ISA 600).

¹⁵⁸ As ISA 320 is revised, changes to ISA 450, *Evaluation of Misstatements Identified during the Audit*, will also likely be required.

Questions

GA5. Which of the possible actions outlined in paragraphs 225–227, would be viewed as most meaningful to address issues related to identifying significant risks for the group audit? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further.

GA6. Do you agree with the possible actions recommended in paragraph 235 to clarify the different aspects of materiality in a group audit? If not, please indicate which actions are not appropriate and describe why. Recognizing that significant changes to ISA 320 will not be contemplated until a review of ISA 320 has been performed in its entirety (potentially as part of a future project to address materiality more broadly), please describe any other relevant issues or additional actions that you think may be appropriate relating to component materiality, component performance materiality or the clearly trivial threshold at the component level.

RESPONDING TO IDENTIFIED RISKS OF MATERIAL MISSTATEMENT IN A GROUP AUDIT

Issues Relating to Audit Procedures Performed on the Component's Financial Information

236. The type of work that is required to be performed on financial information of a component depends on whether or not the component is a significant component. If a component has been identified as significant because of its individual financial significance, the group engagement team or component auditor, on behalf of the group engagement team, performs an 'audit' of a component using component materiality.¹⁵⁹ For a component that is significant because it is likely to include significant risks of material misstatement of the group financial statements, the group engagement team or component auditor, on behalf of the group engagement team, performs an 'audit' of the financial information of the component using component materiality or an audit of the aspects of the financial information to which the significant risk relates or performs specified audit procedures relating to the significant risks.¹⁶⁰

237. For components that are not significant, the group engagement team performs analytical procedures at the group-level.¹⁶¹ The group engagement team or component auditor may also perform one or more of the following on selected individual non-significant components:

- (a) An audit of the financial information of the component using component materiality.
- (b) An audit of one or more account balances, classes of transactions or disclosures.
- (c) A review of the financial information of the component using component materiality.
- (d) Specified procedures.¹⁶²

¹⁵⁹ ISA 600, paragraph 26

¹⁶⁰ ISA 600, paragraph 27

¹⁶¹ ISA 600, paragraph 28

¹⁶² ISA 600, paragraph 29

See also paragraphs 248-261 for further discussion about situations where there are only non-significant components, or a large number of non-significant components.

238. Many facts and circumstances affect how audit work on the financial information of components is planned and performed, including whether the work will be performed by the group engagement team or whether a component auditor will be requested to perform the work. Some examples of scenarios that affect the audit work on the financial information of the components include the following:

- When a component auditor is requested to perform an audit of the financial information of a component using component materiality and the only reporting on the component's financial information by the component auditor is to the group engagement team (e.g., through a clearance memorandum or similar communication), in addition to not applying the ISA reporting standards, the component auditor may, pursuant to the instructions of the group engagement team, also not address requirements of other ISAs when the related procedures are performed centrally for the group as a whole (e.g., the component auditor may not obtain written representations from component management, or may not obtain separate communications from legal counsel when the group engagement team instructs the component auditor not to do so on the basis of having obtained such representations or communications at the group level). This situation applies to significant as well as non-significant components, and would result in the component auditor not applying all ISAs that would be relevant in a financial statement audit.¹⁶³
- Component materiality and component performance materiality for purposes of the group audit will likely be higher than the materiality and performance materiality that are required to be used when a component auditor is also issuing an auditor's report on the component's standalone financial statements. Challenges may therefore arise for the component auditor when planning and performing the work for both purposes, especially when the timing is not aligned (i.e., work performed to support the group audit is often required to be completed sooner to support earlier group reporting deadlines).

239. Certain audit procedures may be performed centrally by the group engagement team for purposes of the group audit, and consequently, it may not be necessary for the component auditor to perform further audit procedures on the related financial information of the component. For example, the identification and assessment of risks of material misstatement, and planning and performance of procedures related to litigation and claims might be performed by the group engagement team on a group-wide basis because they are managed centrally by the entity, even though the component financial information may include related accounts and disclosures. Similarly, the transactions related to some accounts and disclosures may be processed and accounted for in a SSC and the related audit work might be performed by the group engagement team or another auditor (see paragraphs 242 below). ISA 600 also focuses on the responsibilities of the group engagement team rather than the responsibilities of the component auditors (who may also have separate responsibilities relating to standalone reporting requirements in their own jurisdictions, at the component level, and may plan to use the work done for standalone reporting for the purposes of the group audit engagement as well). The possible need for development of separate requirements and related application material dealing with responsibilities of the component auditor is discussed in paragraph 177.

¹⁶³ ISA 200, paragraph 18 requires that the auditor comply with all ISAs relevant to the audit.

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240. Questions have arisen with respect to the nature, timing and extent of procedures being performed on the component's financial information for group audit purposes. As discussed in the group audits introductory section (paragraphs 171–179), it has been observed that scoping of the audit based on the identification of components may not always result in a top-down approach to the assessment of the risks of material misstatement and the responses to those risks. Another possible consequence of scoping the audit based on the identification of components is that the work performed on the financial information may not always be appropriate or sufficient for the purposes of the group financial statements.
241. Questions have also arisen as to the meaning of “an audit of financial information of the component using component materiality”;¹⁶⁴ in particular, whether it means (and therefore requires) applying all relevant ISAs, or whether it means only applying those ISAs or those requirements in specific ISAs as instructed by the group engagement team or that the component auditor has determined are appropriate given the work which they have been asked by the group engagement team to perform. Questions have also arisen as to whether “specified audit procedures” and “audit procedures” referred to in paragraphs 27 and 29 of ISA 600 respectively have the same or a different meaning. Questions have also arisen as to how these procedures relate to the procedures that might be performed as or as part of an agreed-upon procedures engagement performed in accordance with ISRS 4400.¹⁶⁵
242. Further challenges have been noted in instances where some balances are audited in the aggregate or centrally (e.g., when the relating processing and accounting is performed at the group-level or at a SSC)¹⁶⁶ by the group engagement team (or potentially by one of the component auditors or another auditor involved in the engagement). The work performed on group-level balances or at a SSC may also be important to a component auditor's conclusions when an auditor's report on the separate financial statements of the component is issued (e.g., for statutory or other purposes). In such instances, there is a need for relevant information to be communicated to the component auditor by the group engagement team (or by the component auditor or other auditor who has performed the work).
243. Questions have also arisen about the requirement to perform analytical procedures at the group level in respect of components that are not significant components. In many cases, the financial information of non-significant components may be aggregated by management with the information relating to significant components. While ISA 600 does not require that these analytical procedures are substantive analytical procedures, questions arise as to how to plan and perform them and how to use the results in supporting the conclusion that sufficient appropriate audit evidence has been obtained.

¹⁶⁴ The auditor shall comply with all ISAs relevant to the audit. An ISA is relevant to the audit when the ISA is in effect and the circumstances addressed by the ISA exist (ISA 200 paragraph 18).

¹⁶⁵ International Standard on Related Services (ISRS) 4400, *Engagements to Perform Agreed-upon Procedures Regarding Financial Information*

¹⁶⁶ Possible actions to address issues in relation to SSC are discussed in paragraph X-X. These could also apply when the SSC is part of a group.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

244. ISA 600 includes requirements and guidance for determining the type of work to be performed on significant and non-significant components.¹⁶⁷ However, ISA 600 does not deal explicitly with some of the practical challenges set out above.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

245. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- (a) Revisiting the requirements for the types of work required for significant and non-significant components and challenge whether the outcome of applying them results in the work effort on financial information of components being commensurate with the risks of material misstatements in the components and supports the ability of the group engagement team to reach a conclusion that sufficient appropriate audit evidence has been obtained. Such a review of the requirements may for example, include challenging whether the requirement to perform an audit of the financial information of significant components using component materiality is appropriate in all cases, and whether it should be made more flexible. For example, even in significant components, there may be risks of misstatement that may not be relevant to the group financial statements; however performing an audit of the component's financial information using component materiality may not provide an opportunity to eliminate such accounts from the scope of the audit work at the component.
- (b) Alternatively, or in addition, the following possible actions may also be appropriate:
 - (i) Provide guidance to clarify that the manner in which the requirement to perform an "audit of financial information of the component using component materiality" is applied may vary depending on the specific circumstances. For example, it could be clarified that an audit of the financial information of a component performed solely for the purposes of the group audit and where the only reporting by the component auditor is to the group engagement team, may not necessarily mean that the component auditor is expected to apply *all* requirements in *all* relevant ISAs in *all* circumstances. Rather the component auditor would be expected to follow the group engagement team's instructions and communicate clearly as to the scope of the audit performed (that might for example include indicating that some account balances or audit procedures were not performed). In addition to possibly revisiting and providing further clarification as to what the various terms mean in the context of ISA 600, attention could also be focused on emphasizing the need for clear instructions to the component auditors and for a mutual understanding between the component auditor and group engagement team about what is expected of the component auditor.
 - (ii) More clearly distinguish between the types of procedures that could be performed and in which circumstances they might be appropriate (e.g., through providing examples of "specified audit procedures" in specific circumstances and distinguishing them from "an audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement"). Additionally, clarify whether there is a difference between "specified audit procedures" and "audit procedures" and also provide guidance as to

¹⁶⁷ ISA 600, paragraphs 26–31 and A47–A53

how these can be distinguished from agreed-upon procedures that might be performed as part of an agreed-upon procedures engagement performed in accordance with ISRS 4400.

- (iii) Clarify the expected work effort related to analytical procedures at the group level for components that are not identified as significant, including providing additional guidance as to how to plan and perform such procedures and how to use the results in supporting conclusions that risks of material misstatement related to the group financial statements have been addressed.

246. Clarification in the requirements or additional application material about the implications in situations where audit work is performed on balances in the aggregate or processed centrally would also help clarify the procedures to be performed at the components (including in situations when the work is supporting standalone component auditor's reports in addition to the report on the group financial statements). For example, audit work on goodwill impairment may be performed centrally, and further application material could be provided for component auditors about their considerations relating to goodwill amounts that have been allocated to the component (including any charges for goodwill impairment) and the necessary procedures (if any) at the component level.

247. Clarifying the distinction between work performed for the purposes of the group audit and work performed to support, for example, a statutory audit opinion at the component level, as well as providing more application material on relevant considerations for the component auditor in the different circumstances, may help clarify the work to be performed on the components, including for significant and non-significant components.

Issues Relating to Situations Where There are Only Non-Significant Components, or a Large Number of Non-Significant Components

248. In responding to assessed risks of material misstatement, ISA 600 requires the group engagement team to determine the type of work to be performed on the financial information of components. In setting forth requirements for the necessary work effort, the standard distinguishes between components that are significant¹⁶⁸ and those that are not significant (i.e., "non-significant").¹⁶⁹

ISSUES

249. ISA 600 does not specifically require that in making the determination as to what work is necessary for the group as a whole, the group engagement team should consider whether risks of material misstatement remain that are not addressed by work performed on significant components, selected non-significant components, and through work performed at the group level (including auditing of accounts at the group level as well as procedures to evaluate and test group-wide controls and the consolidation process). Determining an appropriate approach to scoping a group audit to obtain sufficient appropriate audit evidence is particularly challenging when there are a large number of components, none of which are significant individually but which in aggregate represent one or more risks of material misstatement to the group financial statements.

250. Audit regulators have expressed concerns that in some cases, it is not clear that auditors have performed a robust assessment as to whether the risks of material misstatement to the group

¹⁶⁸ ISA 600, paragraphs 26–27

¹⁶⁹ ISA 600, paragraphs 28–29

financial statements related to ‘residual balances’ (i.e., those pertaining to components that are not significant and not otherwise selected for testing) are adequately addressed by the rest of the work performed on the group audit, and therefore have challenged whether the work done on such residual balances is adequate. Questions have also been asked as to whether and if so, how a review of a component’s financial information using component materiality provides audit evidence.¹⁷⁰ As noted above, questions have also been asked about the meaning of “specified audit procedures”.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

251. ISA 600 sets out requirements and guidance for procedures that may be relevant for group engagement teams or component auditors to perform in respect to components that are not significant components¹⁷¹. In addition to analytical procedures performed at the group level, procedures may include selecting non-significant components and performing audits of financial information or of select account balances, performing reviews of financial information or specified procedures. The application guidance includes factors to consider when selecting components and indicates that the selection of components is often varied on a cyclical basis.¹⁷²

252. 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 performing work at non-significant components.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

253. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- (a) Strengthening the requirements (with related application material) to address the group engagement team’s considerations about the work to be performed on non-significant components, in addition to the work to be performed on significant components.
- (b) Providing further guidance on how the group engagement team should determine which non-significant components would require procedures and how to determine when a sufficient number of components have been selected for the performance of such procedures, notwithstanding that paragraph A53 of ISA 600 addresses, albeit to a limited degree, the situation where a group may be comprised of components that are not significant components.
- (c) Challenging the role of reviews of component’s financial information, including whether they provide audit evidence. As discussed above, clarify whether there is a difference between the “specified audit procedures” described in paragraph 27 (c) and the “specified procedures” referred to in paragraph 29.

See also possible actions described in paragraphs 236–247 that might result in a more comprehensive revision to the requirements of ISA 600 relating to the type of work to be performed on the financial information of components.

¹⁷⁰ ISA 600, paragraph 29

¹⁷¹ ISA 600, paragraphs 28–29

¹⁷² ISA 600, paragraph A51

Issues Relating to the Group Engagement Team’s Involvement in the Consolidation Process

254. The consolidation process is a necessary element of the financial reporting process for an entity for which group financial statements are prepared. Paragraph 10 of ISA 600 notes that the “consolidation process” includes “the recognition, measurement, presentation and disclosure of the financial information of components in the group financial statements by way of consolidation, proportionate consolidation, or the equity or cost methods of accounting”.
255. Group structures may also necessitate consolidation processes at levels below those of the overall group (i.e., sub-consolidations). As part of obtaining its understanding of the entity, the group engagement team would need to determine whether consolidations of financial information take place at the sub-consolidation level, and the appropriate level of involvement by the group engagement team in such sub-consolidations. Many factors may affect the appropriate level of involvement of the group engagement team in sub-consolidations, including with respect to understanding the controls over the consolidation process at the sub-consolidation level(s). These factors may also affect the group engagement team’s assessed risks of material misstatement (see discussion in paragraphs 217–227 about identifying risks of material misstatement in a group audit) in the consolidation process.

ISSUES

256. The IAASB notes that the reference in the description of the consolidation process to including the financial information of components in the group financial statements using the cost method of accounting, is a source of confusion, as it appears to imply the investments accounted for using the cost method of accounting would or could be considered components. Questions have therefore been raised with respect to whether investments that are carried at cost or measured at fair value meet the definition of components in ISA 600, and about the applicability of ISA 600 to audits of financial statements that include investments of this nature, e.g., as would likely be the case in ‘fund of funds’ structures. The IAASB believes that investments that are carried at cost or at fair value were generally not intended to be encompassed by the definition of component, and also that financial statements including these types investments would not be considered group financial statements.
257. Notwithstanding that the requirements for the group engagement partner’s involvement in the consolidation process are robust, it has been noted that there is no specific guidance in ISA 600 on the group engagement team’s expected involvement in any sub-consolidation processes. Additionally, there is no specific requirement for the group engagement team to verify that the information included in the consolidated process is the same as the information as that on which the component auditor’s work has been performed. It has also been noted that various issues could arise when sub-consolidations are audited by component auditors, and the group engagement team is not appropriately involved, including because the component auditors may not have the full context of the group-wide risks to effectively audit the sub-consolidations. Issues arising include:
- (a) Insufficient information for the group engagement team to understand the consolidation entries processed in the sub-consolidation, some of which may be material to the group.
 - (b) Failure by the component auditor to appropriately consider the accounting for or processing of group-wide journal entries necessary for the sub-consolidation process (e.g., as a result of differing accounting policies used by the components and at the consolidated level).

- (c) Ineffective controls over the consolidation process that are not properly considered by the group engagement team or the component auditors.

258. In addition, it has been suggested that additional perspectives should be sought as to whether more application material 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 through making a more direct link to relevant requirements and application material in ISA 315 (Revised). Such linkage might also highlight relevant disclosures that might be based on information that comes from outside the general ledger. See also paragraph 278 below.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

259. As part of the required understanding of the group, its components and their environments, the group engagement team is required to obtain an understanding of the consolidation process,¹⁷³ with an explicit direction that this understanding includes understand the instructions issued by group management to components. The group engagement team, or the component auditor at the request of the group engagement team, is also required to design and perform further audit procedures on the consolidation process to respond to the assessed risks of misstatement of the group financial statements arising from the consolidation process (i.e., performing substantive procedures and if applicable, testing the operating effectiveness of group-wide controls).¹⁷⁴

260. ISA 600 also requires the group engagement team to:

- (a) Evaluate whether all components have been included in the group financial statements.¹⁷⁵
- (b) Evaluate the appropriateness, completeness and accuracy of the consolidation adjustments and reclassifications and whether any fraud risk factors or indicators of management bias exist.¹⁷⁶
- (c) Evaluate whether appropriate consolidation adjustments have been made to the components for any differences in accounting policies.¹⁷⁷
- (d) Determine that the component information identified in the component auditor's communications has been consolidated.¹⁷⁸
- (e) Make appropriate adjustments for the financial information for any components that have different financial reporting periods.¹⁷⁹

¹⁷³ ISA 600, paragraph 17(b)

¹⁷⁴ ISA 600, paragraphs 32–33

¹⁷⁵ ISA 600, paragraph 33

¹⁷⁶ ISA 600, paragraph 34

¹⁷⁷ ISA 600, paragraph 35

¹⁷⁸ ISA 600, paragraph 36

¹⁷⁹ ISA 600, paragraph 37

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

261. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- In relation to investments carried at cost or at fair value, revisiting the interaction between the definition of component and the description of the consolidation process in ISA 600. This could include:
 - Considering whether to remove the reference to the cost method of accounting in the description of the consolidation process.
 - Clarifying that financial statements that only include investments accounted for at fair value or using the cost method of accounting are not considered group financial statements for the purposes of ISA 600.
- Revisiting the requirements in ISA 600 to determine whether the group engagement team's responsibilities in relation to sub-consolidations need to be clarified or enhanced. This could include recognition that component auditors would 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 for the group audit. In making revisions, it could be emphasized that determining the appropriateness of the group engagement team's involvement would be dependent on the circumstances and structure of the group. The requirements in ISA 600 could also be revised to explicitly require that the group engagement team verify that the information included in the consolidated process is the same as the information as that on which the component auditor's work has been performed.
- New application material could be developed in the context of the group engagement team's responsibilities for the consolidation process (and possible sub-consolidations), to better link, or build on, the requirements and application material in ISA 220 in respect of the engagement partner's responsibilities for the direction, supervision, performance and review of the audit engagement.
- ISA 600 could be enhanced by more explicitly linking to the relevant requirements and application material 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),¹⁸⁰ and adding more application material to ISA 600 to explain how this might apply in the context of a group audit, specifically when sub-consolidations exist.
- Elevating in status to application material or requirements some aspects of the examples of matters to consider when understanding the consolidation process currently contained in Appendix 2 of ISA 600.

Issues Relating to Subsequent Event Procedures

262. Many financial reporting frameworks specifically refer to subsequent events. The auditor's subsequent event procedures address the identification of events that occur after the date of the

¹⁸⁰ ISA 315 (Revised), paragraph 18

financial statements, and that might require adjustment to or disclosure in the group financial statements.

ISSUES

263. Some regulators and audit oversight bodies have noted instances where the group engagement team has not adequately evaluated the work of component auditors in relation to subsequent events, or that the period covered by such work is inadequate.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

264. When audits on the financial information of components are performed, the group engagement team or the component auditors are required to perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements, and that might require adjustment to or disclosure in the group financial statements. When component auditors perform work other than audits of the financial information of components, the group engagement team is required to request that the component auditors notify the group engagement team if they become aware of subsequent events that might require adjustment or disclosure in the group financial statements.¹⁸¹

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

265. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- Clarifying the existing requirements or providing additional application guidance in ISA 600 to emphasize the importance of the group engagement team providing clear instructions to the component auditor about subsequent event procedures and the period that they should cover, and the group engagement team's evaluation of the results of component auditors' procedures.

Questions

GA7. Which of the actions outlined in paragraphs 245–247, 253, 261 and 265, would be viewed as most meaningful to address issues related to responding to identified risks of material misstatement in a group audit? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) What are your views on scoping the audit based on identifying and assessing the risks of material misstatement for the group as a whole rather than focusing the determination of the necessary work effort on the determination of whether components are considered significant or non-significant? Are there any practical challenges that need to be considered further by the IAASB?

¹⁸¹ ISA 600, paragraphs 38–39

- (b) Are there other possible actions related to auditing groups where there are a large number of non-significant components? Are there other approaches to auditing such groups that need to be considered? Do the possible actions presented lead to any additional practical challenges?
- (c) Should the standard be strengthened for the group engagement team to be more involved at the sub-consolidation level in the appropriate circumstances? Are there further issues or practical challenges that have not been considered?
- (d) Should the requirements or application guidance relating to subsequent event procedures be strengthened or clarified? Are there further issues or practical challenges that have not been considered?

REVIEW AND EVALUATION OF THE WORK OF COMPONENT AUDITORS BY THE GROUP ENGAGEMENT TEAM

Issues Relating to Evaluating the Communications from the Component Auditor and the Adequacy of their Work

266. ISA 600 allows flexibility as to the necessary level of involvement in the work of the component auditors by the group engagement team, including as it relates to the review of component auditors' audit documentation. However, when reviewing and evaluating the work performed by the component auditor, the group auditor's considerations would include whether the evidence obtained is sufficient and appropriate in the circumstances and that it supports the group auditor's conclusions in accordance with the ISAs.

267. The group engagement team determines how to evaluate the component auditor's communications and the adequacy of their work based on an evaluation of the circumstances of the engagement, and with respect to each component and its respective component auditors.¹⁸²

268. As discussed in paragraph 210–216 the level and manner of the group engagement team's involvement in the work of the component auditors will vary based on the circumstances of the group engagement. The nature and extent of documentation on the group audit file relating to the evaluation by the group engagement team of the component auditor's findings also varies significantly, and may, for example, as it relates to reviewing the work of component auditors, range from including documentation of a review by the group engagement team of selected working papers prepared by the component auditors, to including copies of the working papers of the component auditor in the group audit file.

ISSUES

269. Concerns have been raised that the flexibility in ISA 600 regarding the nature, timing and extent of necessary involvement in the work of the component auditors, including the review of component auditors' audit documentation, has led to situations where group engagement teams are not able to demonstrate that an appropriate evaluation of the component auditors' findings has been undertaken.

270. It has been noted in particular that the requirement in ISA 600 paragraph 42(b) relating to reviews of relevant parts of a component auditor's audit documentation and the related application guidance in paragraph A61 are not sufficiently detailed to provide appropriate direction to group engagement teams in this regard, i.e., as to when it would be appropriate or expected that a group engagement

¹⁸² ISA 600, paragraphs 42(a) and (b), 43 and A61

team would make the determination that it would be necessary to review component auditor's audit documentation. In addition, it has been suggested that issues may sometimes arise because the review of the component auditors' documentation (including working papers and conclusions) by the group engagement team is not sufficiently documented in the group audit documentation. Therefore, challenges exist related to the group engagement team being able to adequately support the significant judgments made in relation to this review.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

271. ISA 600 requires the group engagement team to evaluate the component auditor's communication of the matters referred to in paragraph 41 and in particular to discuss significant matters arising from that evaluation, as appropriate, and to determine whether it is necessary to review other relevant parts of the component auditor's audit documentation.¹⁸³

272. In addition, as part of the required evaluation of the sufficiency and appropriateness of the audit evidence obtained, the application material notes that the component auditor's audit documentation that may be relevant to the group audit may vary depending on the circumstances.¹⁸⁴

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

273. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- Strengthening the requirement in paragraph 42(b) in ISA 600, and the related application material, to clarify the necessary work effort of the group engagement team in relation to reviewing the component auditor's working papers. Such clarification would likely, therefore, result in better demonstration of the judgments made by the group engagement team as to the appropriateness of their involvement. For example, to encourage the group engagement team to review the work of the component auditor to understand the extent and quality of the procedures performed by the component auditors (including an EQC review undertaken), the requirements and related application guidance could potentially be revised to provide more clarity on when reviews of component auditor's audit documentation by the group engagement team would be appropriate and about the procedures that the group engagement team would perform as part of the review. However, care will be needed to ensure that, all other things being equal, the extent of the review required or expected by the group engagement team does not exceed that which would be undertaken in a non-group audit situation. In addition, further consideration will be given in the quality control project to the involvement and review by the engagement quality control reviewer (see further discussion in paragraph 127). At the same time, the fact that the work of the component auditor may have been reviewed by the engagement partner of the component auditor should also be factored into the determination about the nature and extent of this review.
- Strengthening the documentation requirements regarding the group engagement team's evaluation of the component auditors' communication, including the nature of any review of documentation that was performed by the group engagement team, specifically linking to the requirements in ISA 230.¹⁸⁵ These matters need to be considered in light of the fact that the work

¹⁸³ ISA 600, paragraphs 42 (a) and (b)

¹⁸⁴ ISA 600, paragraph A61

¹⁸⁵ ISA 230, paragraph 8

of the component auditors is likely already reviewed by the engagement partner responsible for the work performed on the component, and that, all other things being equal, this review should not exceed the nature and extent of review by an engagement partner of another partner's work in a non-group situation.

Issues Relating to the Evaluation of the Work of the Component Auditors on the Group Audit Engagement and Whether Sufficient Appropriate Audit Evidence has been Obtained

274. In evaluating whether sufficient appropriate evidence has been obtained, the group engagement team considers the work done on the consolidation process and the work done by and the findings of the component auditors that have been communicated to the group engagement team (see also paragraph 266–273 regarding issues and possible actions regarding the consolidation process and communications between the group engagement team and component auditors).

ISSUES

275. In some cases, the audit documentation may not explicitly demonstrate the group engagement team's judgments, as appropriate, in relation to the evaluation of the findings of the component auditors. For example, some regulators and audit oversight bodies have noted instances where there is insufficient consideration of the effect on the group audit of the component auditor's findings, including the evaluation of whether sufficient appropriate audit evidence has been obtained.

REFERENCES TO EXISTING REQUIREMENTS AND APPLICATION MATERIAL

276. The auditor is required to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level, thereby enabling reasonable conclusions to be drawn on which to base the auditor's opinion.¹⁸⁶ The group engagement team is required to evaluate whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion as a result of 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.¹⁸⁷ The group engagement team's evaluation of the adequacy of the component auditor's work will support the conclusion as to whether sufficient, appropriate audit evidence to support the group audit opinion has been obtained.

POSSIBLE ACTIONS TO ADDRESS THE ISSUES

277. In its discussion about responses to address the issues, the IAASB identified the following possible actions:

- Strengthening the communication requirements between the group engagement team and the component auditors and emphasizing the importance of ongoing two-way dialog (as discussed in paragraph 200). This will support the group engagement team in obtaining the necessary information to evaluate the findings of the component auditor. For example, consultations outside of the component engagement team may be indicative of areas of interest to the group engagement team (for example, such consultations may indicate significant risk not previously

¹⁸⁶ ISA 200, paragraph 17

¹⁸⁷ ISA 600, paragraph 44

identified), and when not communicated may not be properly evaluated by the group engagement team.

- Strengthening the documentation requirements for the group engagement team and emphasizing the importance of appropriately documenting significant judgments relating to the findings of the component auditors. For example, requiring the group engagement team to document that the consideration as to whether a component auditor finding for one component gives rise to increased risk where similar circumstances exist in other components.

Questions

GA8. Which of the actions outlined in paragraphs 273 and 277 would be viewed as most meaningful in addressing issues related to the review and evaluation of the work of component auditors by the group engagement team? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of those actions that you believe the IAASB needs to consider further.

OTHER ISSUES RELATING TO GROUP AUDITS

The Impact of New and Revised Auditing Standards

DISCLOSURES

278. 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 that regard). As a project proposal for addressing issues identified in group audits is developed, consideration will be given to the need to focus more explicitly in the requirements or the application material of ISA 600 on relevant considerations about group financial statement disclosures, including giving consideration to the relevance of financial information of components in this regard.

IDENTIFYING KEY AUDIT MATTERS IN A GROUP AUDIT ENGAGEMENT

279. Consideration will be given for the need for any revised requirements or additional guidance relating to communication of key audit matters (KAM) by the group engagement team in the auditor's report on the group financial statements. For example, it may be appropriate for ISA 600 to include additional application guidance to assist group engagement teams and component auditors in having effective communications so as to ultimately support the identification, where applicable, by the group engagement team of those matters that might be considered and ultimately determined to be KAM in the context of the group audit.

Questions

GA9. In moving forward to developing the project proposal for standard setting, do you have views about how the matters set out in paragraphs 278 and 279 should be addressed? Are there any other implications from the IAASB's new or revised standards that should be considered?

The following questions are overall questions relating to group audits:

GA11. Are there any other issues relating to group audits that the IAASB has not identified? If yes, please provide details, as well as views about actions that the IAASB should take to address them.

GA12. Are there any other specific actions that others could take to address the issues that have been set out in this section of the ITC? If yes, please provide details.

GA13. From the SMP perspective, are there any specific considerations related to the issues and potential actions described in this section of the ITC? Are there any other SMP considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

GA14. Are there any public sector considerations related to the issues and potential actions described in this section of the ITC, or any other public sector considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

Questions for the ITC

(G = General question; PS = Professional Skepticism related question; QC = Quality Control related question; GA = Group Audit related question)

The following is a summary of all questions for respondents that have been included in paragraphs 1–279. The IAASB welcomes responses, including an articulation of underlying reasoning for respondents' views, even if only some of the listed questions are addressed.

General Questions

G1. Paragraph 3 of this ITC describes what the IAASB believes are the most relevant public interest issues the Board should address in the context of its projects on professional skepticism, quality control and group audits. In the context of these three key projects:

- (a) Do you believe these public interest issues are relevant and meaningful to the Board's work on those topics? If not, why not?
- (b) Are there other public interest issues that would be relevant to those topics? If so, please describe them and how, in your view, they relate to the specific issues the IAASB plans to address in relation to the topics.

In your view, are there actions needed by parties other than the IAASB to address the public interest issues the IAASB believes are most relevant to enhancing audit quality in relation to these topics? If yes, what are they and which stakeholders have a role to play in this?

G2. Enhancing audit quality will continue to be a theme as the IAASB develops its *Work Plan for 2017 – 2018*. To assist the IAASB in this regard, are there other actions not specific to the topics of quality control, group audits or professional skepticism that you believe need to be undertaken by the IAASB to address the threats to audit quality more broadly? If yes, what are they and how should they be prioritized?

Professional Skepticism

PS1. The IAASB is exploring what actions it could take to strengthen the application of professional skepticism in audits.

- (a) What are your views about how the concept of professional skepticism is described in the ISAs and addressed in the IESs and the IESBA Code (see paragraph 17 and footnote 12 above)?
 - (i) What are your views about the interactions and contextual factors depicted in the diagram at paragraph 24 above?
 - (ii) Are there other areas beyond those described in paragraph 26 that the Joint Working Group should explore?
 - (iii) What do you think should be done in the context of the IAASB's key projects (i.e., quality control and group audits) to further emphasize application of professional skepticism by auditors)?
 - (iv) What are your views about how the IAASB as part of its other projects and activities (see

paragraphs 30–31), could further challenge auditors to exercise professional skepticism in conducting audits?

- (b) In your view, what action(s) would be most meaningful for the IAASB to undertake in light of its mandate and why?
- (c) How may auditors better demonstrate the exercise of professional skepticism in the audit documentation?
- (d) What other actions may be necessary to strengthen the application of professional skepticism and who, in your view, is best placed to carry out these actions (e.g., other standard setters, firms and member bodies, etc.)?

Quality Control, Including Questions Exploring Crossover Issues/Issues Relevant to More than One Project

The following questions relate to quality control matters set out in paragraphs 35–170. Where you believe actions relating to quality control beyond those discussed in these paragraphs should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.

QC1. The IAASB is strongly considering a broader revision of ISQC 1 that would embed an approach to quality control that would require firm leaders taking responsibility for managing quality in a more proactive and innovative way (see paragraphs 35–51).

- (a) Do you believe that the use of a QMA would assist in improving audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate such an approach?
- (b) If you support the use of a QMA by firms, are there other elements that you think should be explicitly included in such an approach in light of its objective (as outlined in paragraphs 47–51)?
- (c) In your view, how might this change to ISQC 1 impact other ISAs, including ISA 220?

QC2. Which of the actions outlined in paragraphs 68–69, would be viewed as most meaningful to address issues related to engagement partner responsibilities? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Under what circumstances, in your view, could someone other than the engagement partner sign the auditor's report? In these circumstances, what is the work that this person should have to undertake to be able to sign the auditor's report?

QC3. Which of the actions outlined in paragraphs 84–88, would be viewed as most meaningful to address issues related to others participating in the audit? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support

a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Should the IAASB explore revisiting the requirements in ISA 600 that currently preclude the ability to make reference to the work of another auditor? If not, why not?
- (b) Should the IAASB revisit the question of providing increased transparency in the auditor's report about the involvement of others in the engagement?

QC4. Which of the actions outlined in paragraphs 99 and 106–107, would be viewed as most meaningful to address issues related to operating through a network of firms and firms changing business models and structures? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you agree that it would be possible to develop requirements and guidance in the IAASB's standards, which are focused on firms and engagements, at the network level? Please provide a basis for your views. What, if anything, in your view could the IAASB do, including in what specific areas, to address the concerns being expressed about networks of firms?
- (b) What kinds of audit procedures are being performed at these ADMs? What quality control policies and procedures apply to the individuals operating at the ADMs and are these appropriate in the circumstances? In your view, should the requirements in ISQC 1 and ISA 220 specifically require minimum quality control policies and procedures for these types of arrangements, and what should these address?

QC5-QC10 address the more significant issues relating to quality control.

QC5. Which of the possible actions outlined in paragraphs 115–119, would be viewed as most meaningful to address issues related to firm leadership responsibilities for audit quality? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you believe it is necessary to explore how the governance of a firm could be best addressed in ISQC 1?
- (b) Should ISQC 1 specifically address accountability of firm leadership, or appropriate personnel within firm leadership, for matters related to quality, including independence-related matters? If so, how should this be done, and what direction should ISQC 1 provide to firms in appointing appropriate individuals to assume these responsibilities?
- (c) Would the use by firms of a QMA to the design and implementation of their systems of quality control provide better support or context for the importance of quality-related responsibilities for firm leadership, and related accountability, and therefore better facilitate the ability of firms to address these matters?

QC6. Which of the possible actions outlined in paragraphs 127–130, would be viewed as most meaningful to address issues related to the EQC review and the EQC reviewer? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Should ISQC 1 mandate EQC reviews beyond listed entities? If yes, what other entities should be considered and how could the IAASB best define these entities? If no, please explain your reasoning.
- (b) Do you believe it is necessary for the IAASB to require in ISQC 1 that firms define the minimum period of time between when an individual has been the engagement partner and when that individual would be eligible to be the EQC reviewer? If yes, how do you think this should be done and why? If no, please explain why.
- (c) Would you support the development of a separate EQC review standard? If so, please explain why. If you would not, please explain why.

QC7. Which of the possible actions outlined in paragraphs 138–141, would be viewed as most meaningful to address issues related to promote a focus by firms on continuous improvements to quality? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you support the incorporation of a new requirement(s) in ISQC 1 for firms to understand the causal factors of audit deficiencies relating to inspections findings and other reviews? If not, why not? Are there any potential consequences or other challenges of taking this action that you believe the IAASB needs to consider?
- (b) Do you agree with the inclusion of requirements in ISQC 1 for the results of the firm's monitoring of the effectiveness and appropriateness of the remedial actions to be considered in the design and assessment of the effectiveness of the firm's system of quality control? Please provide further detail to explain your response.

QC8. Do you believe it is necessary for the IAASB to create a link between compensation and quality in its standards? Why? If so, how can this best be done? Are there potential consequences of doing so that you believe the IAASB needs to consider?

QC9. Which of the possible actions outlined, or other actions not described, in **Human Resources** and **Engagement Partner Competencies** sections in paragraphs 157-158 and 167, would be viewed as most positively impacting audit quality:

- (a) Arising from issues related to knowledge, skills, competence and availability of a firm's partners and staff?
- (b) Related to engagement partner competencies?

Why do you believe these actions are necessary? Where you would not support a particular action, please explain why not, including any potential consequences of those actions that you believe the IAASB needs to consider.

QC10. Do you believe the IAASB should undertake work in relation to transparency reporting? If so, what, in your view, would be the most appropriate action the IAASB could take at this time in light of the variations in law or regulation, as well as practice, with respect to transparency reporting? Where you would not support a particular action, please explain why not, including any potential consequences of those actions that you believe the IAASB needs to consider.

The following questions are overall questions relating to quality control:

QC11. Are there any other issues relating to quality control that the IAASB has not identified? If yes, please provide details, as well as views about actions that the IAASB should take to address them.

QC12. Are there any other specific actions that others could take to address the issues that have been set out in this section of the ITC? If yes, please provide details.

QC13. From the SMP perspective, are there any specific considerations related to the issues and potential actions described in this section of the ITC? Are there any other SMP considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

QC14. Are there any public sector considerations related to the issues and potential actions described in this section of the ITC, or any other public sector considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

Group Audits

The following questions relate to group audits matters set out in paragraphs 171–279. Where you believe actions relating to group audits beyond those discussed in these paragraphs should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.

GA1. Specific issues have been noted in relation to group audits that suggest improvements to the ISAs are necessary. The IAASB is exploring how ISA 600 (and potentially other standards) may need to be revised to respond to those issues.

(a) Do you believe that more specific emphasis on the application of all relevant ISAs in an audit of group financial statements in ISA 600 is appropriate and that it will help achieve the flexibility that is needed to allow for its application in a broader way, and to a wide range of circumstances (see paragraphs 171–179)? If not, please explain why and provide any additional actions you believe the IAASB could undertake to address issues set out in this consultation.

(b) Do you believe the actions the IAASB is exploring in relation to the issues raised regarding ISA 600 would be meaningful and would improve the quality of group audits? If not, why not?

GA2-GA9 address the more significant issues relating to group audits in greater detail.

GA2. Which of the possible actions outlined in paragraphs 192–194, would be viewed as most meaningful in addressing issues related to acceptance and continuance procedures? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Are access issues as described in paragraph 184(a) still frequently being experienced in practice? If yes, please provide details and where possible, explain how these are being addressed today.
- (b) Do you agree that ISA 600 can or should be strengthened in relation to addressing access issues as part of acceptance and continuance?
- (c) Do you have the view that expanding the understanding required for acceptance and continuance, as described in paragraph 192(b) above, would be achievable in the case of a new audit engagement?

GA3. Which of the possible actions outlined in paragraph 200, would be viewed as most meaningful in addressing issues related to communication between the group engagement team and the component auditor? Why do you believe these actions are necessary? Are there other relevant issues or actions that would be more meaningful and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further.

GA4. Which of the possible actions outlined in paragraph 216, would be viewed as most meaningful in addressing issues related to using the work of the component auditor? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) Do you agree that the nature, timing and extent of involvement of the group engagement team in the work of the component auditor should vary depending on the circumstances? How, in your view, could changes to the standard best achieve this objective?
- (b) Do you agree that the standard should be strengthened to require the group engagement partner or team to make an explicit determination about whether the group engagement team can use the work of a potential component auditor?

GA5. Which of the possible actions outlined in paragraphs 225–227, would be viewed as most meaningful to address issues related to identifying significant risks for the group audit? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described?

Where you do not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further.

GA6. Do you agree with the possible actions recommended in paragraph 235 to clarify the different aspects of materiality in a group audit? If not, please indicate which actions are not appropriate and describe why. Recognizing that significant changes to ISA 320 will not be contemplated until a review of ISA 320 has been performed in its entirety (potentially as part of a future project to address materiality more broadly), please describe any other relevant issues or additional actions that you think may be appropriate relating to component materiality, component performance materiality or the clearly trivial threshold at the component level.

GA7. Which of the actions outlined in paragraphs 245–247, 253, 261 and 265, would be viewed as most meaningful to address issues related to responding to identified risks of material misstatement in a group audit? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you would not support a particular action, please explain why not. Please also describe any potential consequences of possible actions that you believe the IAASB needs to consider further. Specifically:

- (a) What are your views on scoping the audit based on identifying and assessing the risks of material misstatement for the group as a whole rather than focussing the determination of the necessary work effort on the determination of whether components are considered significant or non-significant? Are there any practical challenges that need to be considered further by the IAASB?
- (b) Are there other possible actions related to auditing groups where there are a large number of non-significant components? Are there other approaches to auditing such groups that need to be considered? Do the possible actions presented lead to any additional practical challenges?
- (c) Should the standard be strengthened for the group engagement team to be more involved at the sub-consolidation level in the appropriate circumstances? Are there further issues or practical challenges that have not been considered?
- (d) Should the requirements or application guidance relating to subsequent event procedures be strengthened or clarified? Are there further issues or practical challenges that have not been considered?

GA8. Which of the actions outlined in paragraphs 273 and 277, would be viewed as most meaningful in addressing issues related to the review and evaluation of the work of component auditors by the group engagement team? Why do you believe these actions are necessary? Are there other relevant issues, or actions that would be more meaningful, and that should be considered in addition to the issues or actions described? Where you do not support a particular action, please explain why not. Please also describe any potential consequences of those actions that you believe the IAASB needs to consider further.

GA9. In moving forward to developing the project proposal for standard setting, do you have views about how the matters set out in paragraphs 278 and 279 should be addressed? Are there any other implications from the IAASB's new or revised standards that should be considered?

The following questions are overall questions relating to group audits:

GA11. Are there any other issues relating to group audits that the IAASB has not identified? If yes, please provide details, as well as views about actions that the IAASB should take to address them.

GA12. Are there any other specific actions that others could take to address the issues that have been set out in this section of the ITC? If yes, please provide details.

GA13. From the SMP perspective, are there any specific considerations related to the issues and potential actions described in this section of the ITC? Are there any other SMP considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.

GA14. Are there any public sector considerations related to the issues and potential actions described in this section of the ITC, or any other public sector considerations of which the IAASB should be aware? If so, please provide details and views about such matters, the related issues, the proposed actions described in this ITC, or other actions that the IAASB or others should take to address these matters.