

WIRTSCHAFTSPRÜFERKAMMER . Postfach 30 18 82 . 10746 Berlin

Mr. Tom Seidenstein
Chair
International Auditing and
Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York
NY 10017, USA

Wirtschaftsprüferhaus
Rauchstraße 26
10787 Berlin

Phone +49 30 726161-0
Fax +49 30 726161-212
Email kontakt@wpk.de

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WP Jan Langosch

**Proposed ISA 600 (Revised)
Special Considerations – Audits of Group Financial Statements (Including the Work of
Component Auditors)**

Dear Tom

Dear Ladies and Gentlemen

The Wirtschaftsprüferkammer (WPK) is pleased to take this opportunity to comment on the Exposure Draft (ED) mentioned above.

We would like to highlight some general issues first and provide you with our specific responses to the ED questions subsequently in the **Appendix**.

General Comments:

We very much **support all efforts to improve audit quality** in the public interest.

However, regarding the general approach taken in ED ISA 600, we do have the following **severe concerns**:

1. Asymmetry between centralized risk assessment (top-down-approach) and decentral risk assessment (bottom-up-approach)

According to ED-600.31, the group engagement team **shall take responsibility** for the identification and the assessment of all risks of material misstatement of the group financial statements (centralized risk assessment or top-down-approach).

When the group engagement team involves component auditors in the risk assessment procedures (as described in paragraph 25) or in the identification and assessment of the risks of material misstatement of the group financial statements, the group engagement team shall consider the results of the component auditors' work (ED-600.32), i.e. the results of the risk assessment procedures performed by component auditors and in particular any risks identified and assessed by them. Also, ED-600.25 states that when the group engagement team assigns the design and performance of risk assessment procedures to component auditors, the group engagement team shall consider the results of those procedures.

It is, however, left to the professional judgement of the group auditor, whether or not the group auditor assigns the design and performance of any risk assessment procedures to component auditors. In other words, the group auditor may decide to involve component auditors for risk assessment purposes, resulting in a combination of risk assessment procedures performed centrally (top-down approach) and risk assessment procedures performed decentrally (i.e. locally) by component auditors (bottom-up approach). However, similarly the group engagement team (i.e. the core group engagement team of the audit firm appointed as group auditor) may choose to perform a central risk assessment only without involvement of any risk assessment procedure by component auditors.

Under extant ISA 600 the performance of risk assessment procedure performed by local component auditors and the consideration of the results by the group engagement team, are enforced in a more reliable way. For example extant ISA 600 prescribes the performance of full scope audits for all components that are significant due to their individual financial significance to the group. This requirement guarantees a local, decentralised risk assessment for all such components, regardless of whether these audits are performed by the group engagement team or a component auditor.

If those full scope audits are performed by component auditors, the group engagement team is required to be involved in the component auditor's risk assessment. This includes, as a minimum, discussing with the component auditor the component's business activities, and susceptibility of the component to material misstatement of the financial information due to fraud or error and reviewing the component auditor's documentation of identified significant risks of the group financial statements (extant ISA 600.30). The same minimum requirement applies to any audits performed by component auditors for components that are significant to the group because they are likely to include group significant risks.

In theory, even extant ISA 600 allows the group engagement team to avoid the use of any component auditors by performing full scope audits for significant components by itself. In practice, however, in the case of geographically diverse groups, in particular international or global

groups, the group engagement team has little choice but to use full scope audit-engagements performed by local auditors (either of the same network or not) for proposes of a group engagement team.

Potential negative consequences:

- Whilst extant ISA 600 enforces a decentralised risk assessment (at least for all significant components), proposed ED-600 is characterised by a **strong asymmetry** by favouring a centralised risk assessment (top-down approach) as opposed to a decentralized, local risk assessment performed by component auditors (bottom-up approach). The extent to which local risk assessment is performed is left to the professional judgement of the group auditor. Proposed ED 600 would even allow group auditor to completely refrain from performing decentralised, local risk assessment procedures and to perform a single centralised risk assessment only.

We believe that such an approach is **not convincing** and counterintuitive given the increasing diversification and internationalization of groups that can be observed in recent years.

- From our perspective, maintaining or even strengthening a decentralized risk assessment **would be a more convincing way forward**. The increasingly multipolar global economy strengthens the need to take advantage of a component auditor's more granular understanding of the respective component and its business activities and his extended experience with the economic, legal and cultural environment, in which the respective competent operates.

Accordingly we suggest, that any future version of ISA 600 continues to require a minimum level of decentralised risk assessment activities performed by local component auditors (or the core group engagement team itself), in particular with regard to the larger components and any components affected by significant or heightened risks of material misstatement.

2. Abolishing the requirement to perform full scope audits at component level

Under extant ISA 600.26 the performance of a "full scope audit" was prescribed for all components of a group that are significant due to their individual financial significance to the group.

Proposed ED-600 does not require the identification of significant components, nor does it prescribe a minimum work effort or type of work to be performed for any component of a group, regardless of their size or nature.

Potential negative consequences:

- In contrast to extant ISA 600, the proposed ED-600 allows the group engagement team to decide – based on its professional judgment – whether or not to perform a full scope audit at the component level. In practice the group engagement team **may even decide to perform no full scope audit at all** at the component level, even for the largest or most significant components of a group. Whilst under extant ISA 600 the reader of an ISA 600 group audit opinion could rely on the fact that all components of individual financial significance were subject to a full scope audit, under proposed ED-600 a similar insight is **not available for the users of a group audit report**. This reduces significantly the information of a (future) group audit opinion regarding the work effort and persuasiveness of the procedures performed for purpose of an ISA group audit.
- In addition to this, there is a risk that the abolishment to perform a full scope audit at component level is likely to result in a „**race to the bottom**“ of audit quality in the context of group audit proposals. In particular in tender situations, when group management asks interested audit firms for providing an alternative, minimum scoping approach as part of their proposals, there is a risk that such alternative scoping approaches would **fall significantly short of the current minimum group audit work effort** (i.e. the requirement of a full scope audit to be performed for all individually significant components) in the interest of achieving a more competitive overall audit price.
- Reducing or even abolishing the performance of full scope audits at component level also results in a risk that **neither the group engagement team nor individual component auditors** will have a **comprehensive overview** of the circumstances of individual (significant) components at the time the Group auditor's report is issued (see also section 3 of our comment letter).

In the interest of both audit quality and audit consistency we **suggest** that any future version of ISA 600 continues to require a minimum extent of full scope audits to be performed a component level, at least for the largest and most significant components of a group.

3. Changing the predominant type of work performed at component level from full scope audits into a combination of individual audit procedures for individual pieces of financial information

Extant ISA 600 clearly distinguishes four types of work to be performed at component level (extant ISA 600.27 and 29):

1. An audit of a financial information of a component (also called “full scope audit”),
2. An audit of one or more account balances, classes of transaction or disclosures,

3. A review of the financial information of the component,
4. Specified (audit) procedures.

By clearly distinguishing those four types of work, and by mandating the performance of **full scope audits** for significant components due to size, extant ISA 600 has established a group audit practice, where full scope audits performed at component level represent a predominant audit approach chosen by the group engagement team. In other words: full scope audits on the financial information of individual components, that are performed and completed before the group auditor's report is issued, currently represent the backbone of audit evidence obtained for purposes of a group audit¹.

ED-600 proposes to abolish the obligation to perform full scope audits and to give up the systematic differentiation between different types of work to be performed at component level under extant ISA 600, where full scope audit plays the most prominent role. Instead, we believe that the new ED-600 promotes an approach, where – with regard to the financial information of the individual component – the full scope audit will be replaced by a combination of the following activities (as the “usual” approach taken in practice):

- a. For some selected pieces of the financial information of a component, the group engagement team will perform individual audit procedures centrally and at group level without the involvement of a component auditor (e.g. central audit for revenue transactions of the entire group, see ED-600 A64, A86),
- b. For other selected parts of the financial information of a component, further audit procedures are performed locally / decentralised for individual components by a component auditor (or directly by the core group engagement team, i.e. without using a component auditor) (see ED-600 A87),
- c. For some other parts of the financial information of a component, the group engagement team may choose to completely refrain from performing or instructing any further audit procedures.

Potential negative consequences:

- We believe that one of the consequences of ED-600 will be that in many cases full scope audits currently performed for individual components would be **replaced with a combination of some selected audit procedures** as described above under a. - c. even in situations, where local statutory audits for components will continue to be mandated, we

¹ We appreciate, that different situations may exit in countries or regions without local statutory requirements. However since Germany as well as all EU-Member states will continue to require statutory audits, our comment letter has to be written from that point of view.

expect that component auditors would usually only perform audit procedures as described under b. before the date of the group auditor's report. The remaining parts of the local statutory audits (i.e. full scope audits) can – and often will – be postponed to a later point of time, so that respective **findings** from that kind of work would **not be available for purposes of a group audit**.

- Furthermore we believe that – everything else being equal – a mere combination of individual audit procedures as described under a. - c. and the resulting audit evidence would be **less persuasive** in comparison to a full scope audit performed at component level.
- We also believe that replacing full scope audits with a combination of audit procedures as described under a. - c. means that **neither the group engagement team nor individual component auditors** will have a **comprehensive overview** and understanding of the circumstances of individual components at the time the group auditor's report is issued. In particular in heterogeneous and multinational groups, we see a danger that - due to a less granular understanding of the circumstances at the level of individual components - relevant risks of material misstatements of a component that may be relevant to the group financial statements may not be identified.
- Finally, we believe that the delineation of the extent of work that has to be performed by the component auditor for group audit purposes and the scope of his responsibilities will be less clear, if full scope audits are replaced by individual procedures as described under a. - c. The ISAs represent a clear framework for a component auditor's responsibilities when conducting a full scope audit for purposes of a group audit. The ISAs, however, cannot be used as a framework or even reference point for what precisely a component auditor has to do, when he is instructed to perform some individual audit procedures only (be it individual risk assessment procedures, individual further audit procedures or a combination of both). Neither ISA 315 nor ISA 330 can be applied in isolation, since ISA 200, para 18 and 20 mandates compliance with the entire set of relevant ISAs. Also, current practice under extant ISA 600 shows that specified audit procedures are often ill defined due to a lack of clarity in the respective audit instructions. ED 600, however, does not include any principles or guidance on how the description or delineation of specified audit procedures may be sufficiently improved or standardised to avoid misunderstandings between the group auditor and components auditors regarding their respective responsibilities when instructing or performing specified procedures.

Accordingly, we suggest that any future version of ISA 600 continues to distinguish different types of work that may be performed for the financial information of individual components. We also suggest that the performance of full scope audits for individual components should continue to play the most prominent role in that context.

4. Overreliance on a Centralized Fraud Risk Assessment at Group Level

We believe that abolishing the requirement to perform full scope audits at component level (see section 2 of our comment letter) and the general bias of ED-600 towards a centralised risk assessment (see section 1 of our comment letter) is particularly problematic with regard to the “Fraud Risk Assessment”.

According to extant ISA 600, the requirement to perform full scope audits at least for all components that are significant due to their individual size (extant ISA 600.26) and the requirement for the group engagement team to be involved in the risk assessment of all significant components (i.e. both due to size and due to risk) where component auditors perform an audit engagement, establishes and safeguards a **decentralized fraud risk assessment**. For example, in case of an international group, audits of significant components located in other countries than the parent entity are usually performed by (local) component auditors who have detailed knowledge of the local economic and legal conditions as well as of the cultural environment, including the respective local language. In contrast to the group engagement team, they are in a much better position to perform interviews regarding sensitive issues like fraud with local management and those charged with governance or of any other appropriate counterparts within the local component under audit. Also we believe that the nature of fraud risks and the degree to which they may affect different parts of financial information under audit may differ significantly from country to country, e.g. due to economic, legal or cultural differences. Thus, local component auditors are also in a better position to perform the procedures and risk assessment considerations required under ISA 240 when conducting a full scope audit or an audit of account balances for a particular component.

Finally, the requirement of extant ISA 600.30 for the group engagement team to be involved in the local risk assessment performed for all significant components ensures that the group engagement team is made aware of any fraud risks that component auditors may have identified locally.

We believe that it is **not convincing** to replace the bottom-up fraud risk assessment approach required under extant ISA 600 with a centralised fraud risk assessment approach. ED-600 introduces a fraud risk assessment approach where the group engagement team is only required to perform inquiries at the group level and where it is left to the judgement of the group engagement team whether or not to perform any related fraud risk assessment procedures at component level. And even if the (core) group engagement team decides to perform local risk assessment procedures for some selected components, it is again left to the judgement of the (core) group engagement team to decide whether or not to involve any component auditors with local knowledge when performing those procedures.

Potential negative consequences:

- ED-600 results in an **inappropriate overreliance** on fraud risk assessment procedures performed at group level. We believe, that requiring fraud interviews to be conducted with group management and those charged with governance at group level **only**, whilst leaving it to the complete judgment of the group engagement team whether or not to perform fraud related inquiries with component management or component auditors (see ED-600 A80 last bullet point), neglects the existence of fraud risks at component level and their relevance for the group financial statements in particular in the case of a diversified, large and international group.
- The reliability and the persuasiveness of the fraud risk assessment performed at the component level will be **significantly reduced** by scaling back or even abolishing the involvement of local component auditors in performing fraud risk assessment procedures. Similarly, replacing the entire fraud risk assessment under ISA 240 - that represents an integral and iterative part of a full scope audit performed for a component - by some individually specified risk assessment procedures also reduces the chance of identifying fraud risks that reside a component level.
- ED-600 neglects the importance of local legal and cultural peculiarities of fraud risks. We believe, it is **almost ineffective**, if a member of a (core) group engagement team conducts a fraud interview with component management in another country without sharing the same native language and without an appropriate understanding of relevant economic, legal and cultural differences.

5. **Negative Competitive Effects - in particular for smaller audit firms**

When developing extant ISA 600, a substantial effort was undertaken to safeguard that the group engagement team is able to use the work of component auditors regardless of whether they are members of the same audit network firm or not, in the interest of avoiding a distortion of the competition between different audit firms. We believe that extant ISA was successful in that regard and has led to a current group audit practice, where group auditors can use the results of full scope audits of components that were performed by non-network related component auditors efficiently and without any major obstacles.

An important precondition for using a full scope audit performed by non-network related component auditors is that those audits are performed compliant with the ISAs. In this regard, the use of two different firm specific audit manuals or audit methodologies by two unrelated audit firms does not represent an issue, as long as both methodologies are ISA-compliant.

Only in a few audit areas, extant ISA 600 requires the group engagement team to provide the component auditor with specific audit instructions prescribing or influencing a particular work effort at component level (in particular with regard to significant risks and component materiality). Again, receiving specific instructions regarding component materiality or group significant risks does not prevent a non-related component auditor from using his own firm specific audit methodology.

Under ED-600, however, the group engagement team may need to influence the audit approach taken by a non-network-related component auditor in a much **more comprehensive and granular way**. As explained in para 52 of the explanatory memorandum, *“when component auditors are involved, the group engagement team **remains responsible for the identification and assessment of and responses to the risks of material misstatement** of the group financial statements. The group engagement team therefore needs to direct and supervise the work performed by component auditors and review their work.”* Under these circumstances, differences in audit methodologies or audit manuals used by non-network-related component auditors may represent a significant burden or even obstacle when using their work for purposes of a group audit.

Furthermore, ED-600 A83 explicitly foresees that a group engagement team “may need to communicate its preferred approach [i.e. its own audit methodology] with component auditors or provide instructions”. In other words, a group engagement team may regard it necessary to request a non-network related component auditor to **comply with major parts of its own network-specific audit manual** as a precondition for using the work of such a component auditor.

Potential negative consequences:

- The **increased granularity of the responsibility** of the group engagement team for the **identification and assessment of and responses to** the risks of material misstatement **across all components of a group** may mean that **differences in audit methodologies** or audit manuals used by non-network related component auditors **may represent an obstacle for using their work** for purposes of the group audit. Since the group engagement team will (have to) use its own audit manual as a framework for the sufficiency and appropriateness of audit evidence obtained in response to an assessed risk, this may result in a much more significant interference in the way a component auditor performs an audit than under extant ISA 600.
- The increased responsibility of the group engagement team for the identification and assessment of and responses to the risks across all components also means that **the granularity and the extent of information that needs to be exchanged** between the (core) group engagement team and the component auditors **will increase significantly**.

We expect, for example, that group audit instructions sent to component auditors or highlight memos prepared by component auditors will need to contain information on **individual assessed assertion level risks** and the **nature and the results of individual audit procedures performed** to a much larger extent than under extant ISA 600. Such an intensified communication between the group auditor and the component auditor **can be implemented** much more **easily within a network** than outside the network, due to differences in the software solutions used by different networks to document identified assertion level risks and the performance of further audit procedures.

- This potential negative competitive effect for non-network-related component auditors becomes even more prominent when larger network firms develop their **own group audit software**, enabling them to push down risks identified and further audit procedures specified by the (core) group engagement team into the engagement files of network related component auditors, whilst non-network related component auditor would **not be able to participate** in such an efficient way of exchanging information.
- We believe that the approach described in ED-600 A83, i.e. suggesting that a (core) group engagement team may request and instruct non-network related component auditors to apply major parts of the audit methodology or audit manual of the group auditor, may create an unacceptable competitive disadvantage for smaller non-network-related audit firms when acting as a component auditor.
- The difficulties for using the results of the work of non-network-related component auditors (in particular of small and medium sized audit firms) that are caused by ED-600 in contrast to extant ISA 600 will have harmful repercussions for the European idea of strengthening small and medium-sized companies (including audit firms).

6. Lack of consideration of the practical implications of ISA 540 (Rev.) and ISA 315 (Rev. 2019) in the context of a group audit

As discussed above (see section 1 of our comment letter) ED-600 foresees a centralised risk assessment performed by the group engagement teams (top-down approach). By the time ISA 600 becomes effective (we presume at the earliest in 2 or 3 years), the risk assessment performed in an ISA-Audit will significantly change as a result of implementing ISA 540 (Rev.) and ISA 315 (Rev. 2019). We believe that ED-600 does not yet contemplate or discuss in a sufficient way the practical implications which ISA 540 (Rev.) and ISA 315 (Rev. 2019) will have in the context of a group audit, in particular for the co-operation of a (core) group engagement team with the component auditors.

Examples of major practical changes to the risk assessment triggered by ISA 540 (Rev.) and ISA 315 (Rev. 2019) include:

- The introduction of the concept of a spectrum of inherent risk,
- The application of inherent risk factors,
- A new definition and a new approach for identifying significant risks,
- A more standardised and granular risk assessment for accounting estimates, including the explicit consideration of methods, assumptions and data.

Whilst it remains to be seen how the audit profession changes its risk assessment practices over the next two years, we believe that the following developments can already now be observed:

- Several international audit networks will change their way of assessing their inherent risks from a two level system (e.g. inherent risks are either significant or non-significant) to a system distinguishing three or even more levels (e.g. low, moderate, significant).
- More audit firms will distinguish different types of potential misstatements/root causes as a basis for their risk assessment, as opposed to an assertion-based or an assertion-focused risk assessment.
- Firm-specific audit manuals will foresee more differentiated audit responses (i.e. further audit procedures) in response to the more granular risks of material misstatement.

We believe that the centralisation of such a more granular and detailed risk assessment at the group level poses a **much larger challenge for audit firms than anticipated by ED-600**. Also, it would go significantly beyond the challenge of centralising the current risk assessment practice (i.e. risk assessment performed for ISA-Audits until the busy season 2019/2020).

Potential negative consequences:

- In the case of large, diversified groups, there is a risk that the centralisation of the assessment and documentation of all risk of material misstatement identified throughout the group will become too **confusing or even impractical**. In other words, we believe that a group engagement team that documents (or at least tries to document) all risks identified throughout a large, diversified group “can’t see the forest for the trees”.
- It is to be expected that the more granular risk assessment introduced by ISA 315 (Revised 2019) and ISA 540 (Revised) will result in **more differentiated guidelines** (e.g. audit manuals) on suitable responses to those risks, which makes a centralised planning and documentation of those responses of the respective further audit procedures even more complicated.

- The Group Audit Instructions, which will have to include both information regarding the more granular risk and the more granular further audit procedures, will need to be further **expanded and become potentially confusing**.
- The **competition-distorting disadvantages** of non-network-related component auditors will **increase even further** (ED-600 A83, see section 5 of our comment letter).

7. **Lack of a Framework regarding the Intensity of the Involvement at Component Level**

Extant ISA 600 (Para 30 and 31) clearly defines a minimum involvement of the group engagement team regarding:

- the risk assessment of significant components where an audit is to be performed and
- further audit procedures in response to significant risk performed at component level.

Extant ISA 600 also prescribes the depth of that involvement (see ISA 600.30 a-c and 31 sentence 1 and 2), including for example discussing with the competent auditor the component's business activities and the susceptibility of the component to material misstatement due to fraud or error, reviewing the component auditors documentation of significant risks and evaluating the appropriateness of the further audit procedures to be performed to respond to those significant risks.

Proposed ED-600.23 foresees that the group engagement partner – when planning the direction and supervision the component auditors and the review of their work – “takes into account” areas of higher assessed risk of material misstatement (including significant risks) and areas in the group financial statements that involve significant judgment. Also, ED-600 A50 includes some qualitative considerations on how the direction, supervision and review of the component auditor's work may be tailored, however, without describing any hard thresholds or conditions for a minimum involvement into the work of the component auditor.

We believe that neither the scope nor the depth of the involvement of the group engagement partner is clearly defined under ED-600 and remains **highly judgmental**.

Potential negative consequences:

- The term “takes into account” areas of higher assessed risk or areas that involve significant judgment **does not provide a clear minimum threshold** for the involvement into the work of the component auditor. Accordingly, the focus of the group engagement partner's or team's attention will be very judgmental, even more so in case of a heterogeneous group with a large number of international components. We believe it is unhelpful to

say “takes into account” without explaining “how” to take this into account, e.g. by highlighting the principles that drive that consideration.

- The lack of minimum requirements regarding the involvement in the work performed at component level **will result in a greater inconsistency** of the involvement approaches applied by different audit firms or networks, again in particular with regard to complex international groups. This will also reduce the ability of users of future group audits, including audit committees or any readers of group audit reports, to evaluate the effectiveness and persuasiveness of group audit engagements.

8. Contradictory Principles regarding “At-Equity Components”

If an audit has been performed on the financial statements of a component for statutory, regulatory or other reasons, ED-600.42 allows that the group engagement team **can use such work** as audit evidence for the group audit, under the condition that all relevant requirements of ED-600 have been met with respect to the use of the work of a component auditor.

We fully agree with the proposed approach. It is consistent with the approach under extant ISA 600.3. We believe it is important to maintain the principle that an audit of a component performed for statutory or other reasons can only be used for purposes of a group audit, if all relevant requirements of ISA 600 have been applied. Interestingly, and to our surprise, ED-600 comes to the contrary conclusion in the case of audits performed for financial statements of At-Equity components for statutory or other reasons.

Group engagement teams often experience restrictions on access to information or people when the group has a non-controlling interest in an entity that is accounted for by the equity method. ED-600 A29 second bullet point suggests that the group engagement team may be able to **overcome restrictions** on access to information or people in the case of At-Equity components by:

- Considering financial information that is available from group management, as group management also needs to obtain the components financial information in order to prepare the group financial statements [which may include both audited and unaudited financial statements],
- Considering publicly available information, such as audited financial statements.

In other words ED-600 A29 implies that the group engagement teams may use audited financial statements of At-Equity components for purposes of a group audit regardless of the fact that several requirements of ED-600 have not been complied with due to restrictions of access to information or members of the audit team performing the audit of an At-Equity component.

We believe that the two approaches described in ED-600.42 and in ED-600 A29 are **contradictory and mutually exclusive**.

Potential negative consequences:

- ED-600 does **not provide a practicable approach** how to overcome a lack of audit evidence due to access restrictions in the case of an “At-Equity Component”. It is unhelpful to imply that (statutory) audits performed for an At-Equity component can be used for group audit purposes, without explaining how the group engagement team can comply with ED-600.42. We believe it is impracticable to comply with that paragraph, (i.e. to evaluate the appropriateness of the audit procedures performed in the statutory audit, the materiality applied for the statutory audit and the competence and capabilities, including the independence, of the statutory auditor) if the group engagement teams does not have access to the relevant information or the respective team-members of the statutory auditor.
- We believe that ED-600 A50 falls short of the respective approach taken under extant ISA 600 A15 and A16 with regard to At-equity components that are significant components. Under extant ISA 600, access restrictions on information of a significant (At-equity) component will result in an inability to obtain sufficient and appropriate audit evidence and ,accordingly, a respective qualification of the group audit opinion due to a scope limitation (see also extant ISA 600 Appendix 1). In other words, extant ISA 600 mandates an involvement in the work performed for significant At-Equity component in order to avoid a respective qualification of the group auditors report. ED 600 proposes to abolish the mandatory involvement regarding the audits of significant “At-Equity components”. We believe that such a change is **particularly unhelpful**, since it will significantly weaken the position of the group engagement team when requesting access to relevant information of a significant At-Equity component.

9. Strengthening the group audit principles of extant ISA 600 - a missed opportunity!

Extant ISA 600 became effective more than 10 years ago. Over that period of time, the standard has established a number of generally accepted group audit principles, which are well known in the global audit profession and even by many audit clients. Examples of these group audit principles are the identification of significant components (extant ISA 600.12 and 18a), the requirement to perform full scope audit-engagements for components that are significant due to their size (extant ISA 600.26), and a prescribed minimum involvement of a group engagement team in the work performed by component auditors (extant ISA 600.30 and 31) and a clear distinction of four different types of work to be performed at component level (extant ISA 600.27 and 29).

Instead of abolishing all these principles – as foreseen by ED-600 – we suggest maintaining and further strengthening these established group audit principles as follows:

1. ISA 315 (Rev. 2019) will have to be implemented in 2 years time. The introduction of the spectrum of inherent risks and inherent risk factors will lead to more standardized and granular way of identifying, assessing and documenting risks of material misstatement. We believe that once those principles are implemented for audits performed for individual components, a group engagement team applying extant ISA 600 will be in a significantly better position to be involved in the risk assessment of component auditors (e.g. in case of significant components) or to request component auditors to report relevant results of their risk assessment to the group engagement team in a standardised way (e.g. in case of non-significant components). We believe that ISA 315 (Rev. 2019) offers the opportunity to result in a significantly improved communication between the group engagement team and component auditors about their results of the risk assessment. This opportunity has not yet been sufficiently explored and ought to be discussed in more depth by adding respective application guidance to the involvement requirements of extant ISA 600.
2. One of the backbones of extant ISA 600 is the identification of "group significant risks". Group significant risks are important for the current group audit approach in two ways: Firstly, they result in the identification of components that are significant due to risk (extant ISA 600 A6). Secondly, they result in involvement requirements regarding the further audit procedures performed in response to those significant risks by component auditors (extant ISA 600.31).
Again, we believe that the issuance of ISA 315 (Rev. 2019) provides an opportunity to significantly improve the quality of group audits performed under extant ISA 600. ISA 315 (Rev. 2019) introduces a new definition for the term "significant risk" and aligns that definition with the concept of the spectrum of inherent risks and the application of inherent risk factors. Implementing this new definition of the term "significant risk" for purposes of identifying group significant risks provides the group engagement team with the opportunity of a more robust and consistent identification of these group significant risks. This can be further strengthened, for example, by requesting component auditors to report any kind of significant risks identified locally (including those for local statutory audits) to the group engagement team, thus providing it with a more holistic overview of which significant risks exist across all components of a group. Again, we suggest that extant ISA 600 should be strengthened by adding application guidance on the identification of group significant risks based on the new principles of ISA 315 (Rev. 2019).

3. The above considerations also apply to accounting estimates and related disclosures in the context of a group audit. The implementation of ISA 540 (Rev.) by the global audit profession, which is currently taking place, provides group engagement teams with the opportunity of identifying risks associated with accounting estimates on a group wide basis in a much more consistent way. Again, we believe that ISA 540 (Rev.) provides the opportunity to develop guidance to complement extant ISA 600 on auditing accounting estimates in a group audit. E.g. the group engagement team could request component auditors to report back their findings and assessments with regard to methods, assumptions and data for any accounting estimates identified at component level in a standardised way. This will also improve the group engagement team's ability to identify accounting estimates that are associated with group significant risks.
4. Extant ISA 600.42 (b) includes a relatively weak review requirement regard the component auditor's documentation. Currently, it is a complete judgment call of the group engagement team to decide whether or not to perform such a work paper review (*"the group engagement team shall determine whether it is necessary to review other relevant parts of the component auditor's audit documentation"*). Instead of completely redefining the term "group engagement team" (by including the component auditors) as proposed in ED-600/ED-220, it would be a much easier and straightforward approach to strengthen the review requirement of extant ISA 600.42, e.g. by introducing and specifying a minimum extent of working paper reviews to be performed when using the work of component auditors. We believe that adding a requirement and respective application guidance on which parts of the documentation for audits of significant and non-significant components need to be reviewed by the group engagement team will result in an immediate and effective improvement of both the overall involvement of the group engagement team and the group audit quality.
5. **We strongly urge the IAASB to examine all possibilities for sharpening and reemphasizing the existing requirements of extant ISA 600 and supplementing the respective application materials to pursue the opportunities of improving group audit quality as described above. This is of particular importance with regard to the potential audit quality improvement triggered by implementing ISA 315 (Rev. 2019) and ISA 540 (Rev.) in the context of a group audit.**

Summary:

In the light of our concerns mentioned above, we do have considerable doubts that the four **key public interest matters** mentioned in para 14 of the explanatory memorandum can be achieved by ED-600:

- **Keeping the Standard fit for purpose**

ED 600 introduces a strong imbalance between a mandatory, centralized risk assessment performed at group level and a merely optional, decentral risk assessment performed at component level by component auditors. By strongly favouring the centralized risk assessment (top down approach) over the decentral, local risk assessment (bottom up approach), in our opinion, ED 600 ignores the particular audit challenges resulting from the trend towards evermore heterogeneous, complex or multinational groups (see section 1 of our comment letter).

Abolishing any requirement to perform full scope audits at component level (extant ISA 600.26) and giving up the clear distinction between different types of work to be performed at component level (established by extant ISA 600.27 and 29) results in a notion that it may be sufficient and acceptable to cover the financial information of individual components by a combination of individual audit procedures for individual line items, some of which performed centrally at group level by the (core) group engagement team and some others locally by component auditors (see ED 600.A86 and A87). We are concerned that this may lead to a systematic and widespread replacement of full scope audits, performed at component level for group audit purposes, by a combination of specified audit procedures for individual line items (see sections 2 and 3 of our comment letter). We do not believe that such a development is in the interest of group audit quality. Further, abolishing the requirement to perform full scope audits at component level and the general bias of ED-600 towards a centralised risk assessment is particularly problematic in the area of identifying and assessing fraud risks (see section 4 of our comment letter). Maintaining a sufficient degree of a decentral, local fraud risk assessments – ideally performed by component auditors with sufficient local knowledge and as an integral part of a full scope audit – is an indispensable prerequisite for group audit quality and ought to be safeguarded by respective minimum requirements within ISA 600.

With regard to at-equity-components, in our opinion, ED 600 does not provide practicable solutions to address restrictions on access to relevant information and people. In the case of significant at-equity-components, it even falls short of the approach taken under extant ISA 600 (see section 8 of our comment letter).

Last but not least, we are concerned that ED 600 may result in several competitive disadvantages in particular in situations when smaller and medium sized audit firms that are

not related to larger networks act as component auditors (see section 5 of our comment letter). Also in this regard, ED-600 falls short of extant ISA 600 which – due to our experience – successfully avoided such a distortion of competition within the audit profession.

- Encouraging management of quality at the engagement level

In our opinion, ED 600 does not contain clear principles or a framework regarding the involvement of the group engagement team and the respective partner in the work performed by component auditors (see section 7 of our comment letter). Abolishing any distinction between significant and non significant components or different types of work to be performed at component level is harmful in this context.

Also, we believe that instead of redefining the term “group engagement team” (by including the component auditors) as proposed in ED-600/ED-220, it would be a much more effective and straightforward approach to strengthen the respective review requirement of extant ISA 600.42, e.g. by introducing and specifying a minimum extent of working paper reviews to be performed when using the work of component auditors (see section 9 of our comment letter).

- Fostering independent and sceptical mind set

As discussed above, we have severe concerns regarding the abolishment of any requirement to perform full scope audits at component level and the strong bias of ED towards a mandatory centralised risk assessment (top down approach) as opposed to a merely optional decentral risk assessment (bottom up approach), (see for further details sections 1 to 3 of our comment letter) We are convinced that – everything else being equal – a combination of several “full blown” risk assessments performed locally and independently at component level by several different component auditors is more in line with the concept of an independent and sceptical mind set than a single risk assessment performed at group level by the group engagement team. Whilst this applies to all potential sources for risks of material misstatements, it is of particular importance in the area of fraud risks (see section 4 of our comment letter).

- Reinforcing robust communication

The increased responsibility of the group engagement team for the identification and assessment of risks across all components and for the respective further audit procedures performed at component level will lead to a **significant increase in the granularity and the extent of information that needs to be exchanged** between the (core) group engagement team and the component auditors (see section 5 of our comment letter). The inclusion of information on **individual assessed assertion level risks** and the **nature**

and the results of individual risk assessment procedures or further audit procedures will make group audit instructions or highlight memos even more complex than today.

Also, whilst the ISAs provide a clear framework for the responsibilities of a component auditor when performing an audit at component level, there is no such framework for specified audit procedures (see section 3 of our comment letter). Given the absence of a clear delineation of the responsibilities of a component auditor when performing specified procedures, we are concerned that the more widespread inclusion of individual risk assessment procedures or further audit procedures in group audit instructions or highlights memos will reduce the clarity of the respective responsibilities of both the group auditor and the component auditor and lead to a higher risk of respective misunderstandings. Finally, we believe that the practical implementation of the changes to risk assessment triggered by ISA 315 (Revised 2019) will further increase the complexity of information regarding assessed risks and the nature or further audit procedures when proposed ISA 600 is planned to become effective (see section 6 of our comment letter). This may result in an increased risk in terms of an information overload or even impracticabilities in the communication between the group auditor and component auditors.

Given these considerations and concerns, we believe that overall, ED 600 fails to achieve the key public interest matters mentioned above.

Therefore, we are unfortunately forced to reject ED 600 in its entirety.

Instead, **we strongly urge the IAASB to examine all possibilities for sharpening and reemphasizing the existing group audit principles and requirements of extant ISA 600** and supplementing the respective application materials with **a particular focus on the potential audit quality improvement offered by implementing ISA 315 (Rev. 2019) and ISA 540 (Rev.) in the context of a group audit** (see section 9 of our comment letter).

We hope that our comments are helpful. If you have any questions relating to our comments or if you wish to explore any considerations made in our letter, we should be pleased to discuss such matters further with you.

Kind regards



Dr. Reiner Veidt
Chief Executive Officer



WP Heiko Spang
Head of Auditing and Accounting

Appendix**Overall Questions:****1. With respect to the linkages to other standards:****(a) Does ED-600 have appropriate linkages to other ISAs and with the proposed ISQMs?**

No, see section 6 and 9 of our comment letter. We believe that ED-600 does not take account of the more granular risk assessment considerations of ISA 315 (Rev. 2019) and ISA 540 (Rev.).

(b) Does ED-600 sufficiently address the special considerations in a group audit with respect to applying the requirements and application material in other relevant ISAs, including proposed ISA 220 (Revised)? Are there other special considerations for a group audit that you believe have not been addressed in ED-600?

No, see answer to question 1. (a).

2. With respect to the structure of the standard, do you support the placement of sub-sections throughout ED-600 that highlight the requirements when component auditors are involved?

From a formal point of view we do not disagree with the placement of sub-sections throughout ED-600 that highlight the requirements when component auditors are involved.

However as explained in our comment letter we fundamentally disagree with the split of work between the group auditor and component auditors as proposed in ED-600 (see sections 1-4 and 6-7 of our comment letter).

3. Do the requirements and application material of ED-600 appropriately reinforce the exercise of professional skepticism in relation to an audit of group financial statements?

No. We believe that a centralised risk assessment (bottom-up approach) that informs a group engagement team about potential risks at group level collected by several independent component auditors at the operational level of the group (i.e. at the level of individual components) is more in line with the principles of professional skepticism in comparison to a centralised risk assessment that relies primarily on information that is held at the head quarter level (including group management and those charged with governance of the group). We believe that a decentralised risk assessment is particularly important, the larger, the more international or the more heterogeneous the group is. We emphasise again that ED-600 does not include a minimum level

of a decentralised risk assessment and in that regard falls significantly short of extant ISA 600.

Specific Questions

4. Is the scope and applicability of ED-600 clear? In that regard, do you support the definition of group financial statements, including the linkage to a consolidation process? If you do not support the proposed scope and applicability of ED-600, what alternative(s) would you suggest (please describe why you believe such alternative(s) would be more appropriate and practicable).

Yes. We believe the scope of ED-600 is clear and we support the definition of group financial statements, including the linkage to a consolidation process.

5. Do you believe the proposed standard is scalable to groups of different sizes and complexities, recognizing that group financial statements, as defined in ED-600, include the financial information of more than one entity or business unit? If not, what suggestions do you have for improving the scalability of the standard?

No, we disagree that the proposed standard is scalable to groups of different sizes and complexities. Whilst extant ISA 600 requires the group auditor to analyse the significance of individual components carefully, resulting in the identification of significant components due to size and due to risks, ED-600 abolishes similar considerations and requirements. Similarly extant ISA 600 prescribes minimum work efforts (i.e. types of work) for significant components and the minimum involvement levels of group engagement teams in the work performed for significant components, ED-600 does not include comparable principles that acknowledge the size and complexities of components - and thereby the complexity of the entire group. In general we believe that ED-600 is particularly negligent with regard to special considerations to multinational and heterogeneous groups.

6. Do you support the revised definition of a component to focus on the 'auditor view' of the entities and business units comprising the group for purposes of planning and performing the group audit?

No, we disagree. We believe that as described under extant ISA 600 A2 groups may also organise their reporting systems in various ways. Group management may for example decide to base their group financial reporting system on an organisational structure where the financial information is prepared separately by a parent entity and its subsidiaries. In other cases, group man-

agement may decide to organise their reporting systems across legal entities by functions, processes, products or services. We believe that the way how management organises the reporting system has significant repercussions for aspects like the completeness of financial information or the consolidation process. It is therefore highly relevant for the risk assessment consideration of the group auditor. Accordingly we believe that the group engagement team should follow a “management view” rather than an “auditor view” when defining the components for purpose of a group audit.

7. With respect to the acceptance and continuance of group audit engagements, do you support the enhancements to the requirements and application material and, in particular, whether ED-600 appropriately addresses restrictions on access to information and people and ways in which the group engagement team can overcome such restrictions?

No, we do not support the changes proposed by ED-600 in particular with regard to restrictions on access to information in case of “At-equity components” (see section 8 above).

8. Will the risk-based approach result in an appropriate assessment of the risks of material misstatement of the group financial statements and the design and performance of appropriate responses to those assessed risks? In particular, the IAASB is interested in views about:

(a) Whether the respective responsibilities of the group engagement team and component auditors are clear and appropriate?

No, we disagree: see in particular sections 1-4, 6, 7 and 9 above.

(b) Whether the interactions between the group engagement team and component auditors throughout the different phases of the group audit are clear and appropriate, including sufficient involvement of the group engagement partner and group engagement team?

No, we disagree: see in particular sections 7 and 3 above.

(c) What practical challenges may arise in implementing the risk-based approach?

No, we disagree: see in particular sections 4, 5 and 6 above.

9. Do you support the additional application material on the commonality of controls and centralized activities, and is this application material clear and appropriate?

No comment.

10. Do you support the focus in ED-600 on component performance materiality, including the additional application material that has been included on aggregation risk and factors to consider in determining component performance materiality?

No comment.

11. Do you support the enhanced requirements and application material on documentation, including the linkage to the requirements of ISA 230? In particular:

(a) Are there specific matters that you believe should be documented other than those described in paragraph 57 of ED-600?

No comment.

(b) Do you agree with the application material in paragraphs A129 and A130 of ED-600 relating to the group engagement team's audit documentation when access to component auditor documentation is restricted?

Yes, we agree with the application material in paragraphs A129 and A130 of ED-600.

12. Are there any other matters you would like to raise in relation to ED-600?

See our general comments in the sections 1-9.

Request for General Comments

13. The IAASB is also seeking comments on the matters set out below:

(a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-600.

No comment.

(b) Effective Date—Recognizing that ED-600 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of a final ISA.

Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

No comment.