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May 16, 2016

Ms. Kathleen Healy  
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529 Fifth Avenue  
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**Re: Invitation to Comment – Enhancing Audit Quality in the Public Interest—A Focus on Professional Skepticism, Quality Control and Group Audits**

Dear Ms. Healy:

The American Institute of Certified Public Accountants (AICPA) is pleased to respond to the above referenced Invitation to Comment (“ITC”).

The AICPA is the world’s largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a history of serving the public interest. AICPA members represent many areas of practice, including business and industry, public practice, government, education and consulting. Among other things, the AICPA sets ethical standards for the profession and U.S. auditing standards (GAAS) for private companies, nonprofit organizations, and federal, state and local governments.

This letter provides the AICPA Auditing Standards Board’s (ASB) response to the ITC within the context of reporting by nonissuers under GAAS. The ASB is the AICPA’s senior committee for auditing, attestation, and quality control applicable to the performance and issuance of audit and attestation reports for nonissuers. Its mission is to serve the public interest by developing, updating, and communicating comprehensive standards and practice guidance that enable practitioners to provide high-quality, objective audit and attestation services to nonissuers in an effective and efficient manner.

We commend the International Auditing and Assurance Standard’s Board (IAASB) initiative to solicit input and explore possible revisions in standards and guidance related to the areas of Professional Skepticism, Quality Control, and Group Audits. We appreciate the opportunity to provide our comments which are organized by the three areas of the ITC.

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## **Professional Skepticism**

### ***General Comment***

We support the IAASB's efforts to reinforce the concept of professional skepticism in current projects around quality control, group audits, and auditing accounting estimates. Specifically, we believe it would be helpful for the revised application material in these projects to provide guidance on obtaining and documenting audit evidence in a way that demonstrates the appropriate application of professional skepticism. However, in the long-term, we believe fundamental improvements need to be made to the definition of professional skepticism and related application material.

In the 2013 monograph, *Enhancing Auditor Professional Skepticism*, published by the Global Public Policy Committee (hereafter, 2013 GPPC monograph), the committee chairs stated, "The term professional skepticism is widely used but may mean different things to different organizations and individuals."<sup>1</sup> There is a lack of common understanding regarding what professional skepticism is and how it should be applied and documented. We believe that the lack of common understanding has led to the inconsistent application of professional skepticism, which is affecting overall audit quality and contributing to the level of inspection deficiencies. We believe that a more complete and practical definition of professional skepticism, combined with application material in the International Standards on Auditing (ISAs), can fill an important void that currently exists in the professional literature regarding a common understanding of the proper application of professional skepticism. We do not believe auditor performance or a collective understanding will improve if the IAASB simply adds more words in the ISAs emphasizing the need for auditors to be skeptical without providing a clearer definition and practical application of professional skepticism.

In the long-term, we support the inclusion in the standards of a professional skepticism framework, which would help answer important questions such as:

- What is professional skepticism and what does it involve?
- Are there varying levels of skepticism and if so what factors indicate the need for heightened professional skepticism?
- How does the auditor appropriately respond when more skepticism is warranted (including in situations of higher levels of assessed risk or situations where the evaluation of evidence indicates the initial risk assessment may not have been accurate)?
- What actions demonstrate the appropriate application of professional skepticism?

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<sup>1</sup> <http://www.thecaq.org/docs/research/skepticismreport.pdf>

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- How does the application of professional skepticism relate to the nature, timing, and extent of audit procedures used to obtain sufficient appropriate audit evidence?
- How is skepticism appropriately evidenced or documented in the working papers?

We recognize that improvement in the application of professional skepticism in practice will take more than just revisions to the auditing standards, and we commend the efforts of the IAASB to engage with other stakeholders. We believe that those efforts combined with feedback from the ITC will provide the IAASB with sufficient information and understanding to take the necessary and important foundational steps to improve the definition of, and application material associated with, professional skepticism. By doing so, the IAASB will provide a clarified and common understanding of professional skepticism that other stakeholders such as the National Standard Setters, the International Accounting Education Standards Board, the International Ethics Standards Board for Accountants, accounting firms, regulators, inspectors, and users of financial information can build upon. We also believe the insights gained in this process can be shared with academics to identify opportunities for future research and to enhance curricula around skepticism.

***PS1. Is your interpretation of the concept of professional skepticism consistent with how it is defined and referred to in the ISAs? If not, how could the concept be better described?***

While the long-standing ISA definition of professional skepticism contains important and necessary concepts, the definition is vague and ambiguous, leaving it open to different interpretations by various stakeholders as to what it is and whether the level of professional skepticism should be held constant throughout the audit and across audit areas regardless of the risk of material misstatement.

In situations where a regulator in an inspection identified insufficient professional skepticism as a finding, it is not always clear whether the auditor:

- a. actually did lack skepticism, which led to insufficient evidence and documentation;
- b. had an appropriately skeptical attitude but it did not lead to an appropriate response;
- c. had an appropriately skeptical attitude and took the proper actions, but failed to adequately document the actions; or
- d. applied proper skepticism, took appropriate action given the facts and circumstances, properly documented the findings in compliance with the ISAs, but the inspector's assessment was different due to hindsight/outcome bias or due to the inspector applying a different interpretation of how skepticism should be applied and documented.

It is often difficult to answer these questions because there is not a common understanding of professional skepticism or its application.

We believe standards should reflect that the proper application of professional skepticism is *more than an attitude*—it also involves, when appropriate and in combination with professional judgment, action, a critical evaluation of audit evidence, and documentation that tells the story of

how professional skepticism was applied.<sup>2</sup> Recent academic research suggests that measures reflecting professional skepticism include actions regarding the nature, timing and extent of audit procedures.<sup>3</sup> After an audit is complete, others wanting to evaluate the application of professional skepticism may determine whether sufficient appropriate evidence was obtained and whether professional skepticism was appropriately applied—meaning the evaluators are looking for an observable audit response. When there is a lack of appropriate response to risks and/or insufficient evidence documented in the work papers, the auditor is often deemed to have lacked sufficient professional skepticism. In re-defining professional skepticism and in revising application material, we think it is important to reach a common understanding of professional skepticism with other stakeholders, including regulators and inspectors.

The figure on page 13 of the ITC depicts a linear model starting with “Professional skepticism is an attitude.” However, we suggest that three concepts (professional skepticism, risk assessment, and professional judgment) jointly lead to action. For example, as the risk of, and opportunity for, management reporting bias increases, there should be heightened professional skepticism and heightened skeptical action. As audit evidence is obtained from an action, professional skepticism and professional judgment again come into play in evaluating and interpreting the evidence and in determining whether additional action is required. Thus, the joint applications of professional skepticism, judgment, risk assessment, and evidence evaluation involve an ongoing and iterative process until sufficient appropriate audit evidence has been obtained and documented. The iterative nature of these processes may need to be recognized in a revised definition of professional skepticism. Therefore, we recommend the IAASB consider specifically addressing in ISA 500, *Audit Evidence*, the correlation between sufficient appropriate audit evidence and the proper application of professional skepticism.

Furthermore, in the standards there is a lack of clarity as to circumstances when it would be appropriate to apply more or less skepticism, and how those applications would differ in terms of action and documentation. While an attitude of a questioning mind should always be present, it seems the evaluation and discussion of skepticism as it currently stands is often in a binary context—either it was appropriately “on” or inappropriately “off.” Current auditing literature suggests that there are aspects of an audit where professional skepticism is *especially important* and *particularly relevant*. If there are areas or situations where it is especially important or particularly relevant to apply professional skepticism, then it is logical that there are areas where it may be less important or relevant. Therefore, we encourage the IAASB to carefully address questions such as: Why is professional skepticism more important in areas that are judgmental or subjective, or in areas where the validity of evidence provided by management is questionable? What are the specific factors that make professional skepticism more important in these areas and less important in others and does this imply different levels of professional skepticism? In areas where auditors may be less skeptical, what circumstances (such as unexpected errors or falsification of

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<sup>2</sup> While the concept of “a critical assessment of audit evidence” may imply an action and related documentation, in practice the definition of professional skepticism is often abbreviated to just the first components of *attitude* and *questioning mind*. This is illustrated in paragraph 26 of the ITC where it states, “*While professional skepticism is an attitude...*” Similarly the first box in the figure on page 13 of the ITC indicates, “*Professional skepticism is an attitude.*”

<sup>3</sup> See “The Way Forward on Professional Skepticism: Conceptualizing Professional Skepticism as an Attitude” (Nolder and Kadous 2014, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2524573](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2524573))

documents) may cause the auditor to revise his/her thinking to heighten skepticism? The 2013 GPPC monograph suggests that there is a professional skepticism continuum where the appropriate application of professional skepticism in a particular area depends on the risk of material misstatement.

We think that without specifically acknowledging a continuum of professional skepticism, the profession will continue to observe execution errors that may be deemed to be caused by a lack of professional skepticism. Importantly, academic research indicates there are instances when regulatory inspectors interpret the evidence and documentation required to demonstrate the appropriate application of professional skepticism required by standards differently than do engagement teams.<sup>4</sup> For example, in lower risk situations, if inspectors expect a heightened level of professional skepticism and action, as evidenced by the level of testing and other audit documentation, it could lead to unnecessary cost and “inspection risk” that could ultimately lower audit quality.<sup>5</sup> Yet, under the current vague definition of professional skepticism in the ISAs, it is apparently not clear to inspectors what the appropriate level of professional skepticism is across the risk continuum. We believe that the lack of common understanding and practical application material around professional skepticism is contributing to misunderstandings on how to properly apply professional skepticism and to disagreements on what constitutes a skepticism inspection deficiency.

We encourage the IAASB to consider the following specific improvements (the first three points represent long-term improvements, while the last recommendations can be applied in the short-term):

- Redefine professional skepticism to include *more* than a questioning mindset or attitude.
- Incorporate the logic of a skepticism continuum that links higher levels of risk of material misstatement to more skeptical mindset and skeptical actions. The continuum would recognize that it is always important to have a questioning mind, but would clarify when the auditor should apply more or less of a challenging mindset and skeptical action.
- Adopt a framework for professional judgment and professional skepticism (based on a continuum) into the standards to assist auditors follow a rigorous process to consistently and appropriately apply professional judgment and skepticism. The goals of basic frameworks are to provide a common vocabulary and understanding of how important concepts are applied in practice and documented in the work papers. The common

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<sup>4</sup> See for example, *Mind the Gap: Why do Experts Disagree on the Sufficiency of Audit Evidence Supporting Complex Fair Value Measurement?* (Glover, Taylor, Wu 2015; <http://ssrn.com/abstract=2504521>).

<sup>5</sup> “Inspection risk” refers to settings where regulatory inspectors focus is not properly aligned with relevant audit risks. As auditors expend effort to manage inspection risk in areas that are not sufficiently correlated with risk of material misstatement it may draw attention away from areas that present greater audit risk. See the 2013 GPPC monograph and Glover, Taylor, Wu (2015; <http://ssrn.com/abstract=2504521>).

vocabulary and processes can then be used in training, coaching, and evaluation of auditor performance.<sup>6</sup>

- Improve application material to illustrate techniques associated with the proper application of professional skepticism in various circumstances and assertions. These may include illustrations of areas of heightened risk where the actions, evidence gathered, and documentation demonstrate the appropriate application of professional skepticism (for example, actions that challenge management’s assumptions, evaluation of potentially disconfirming information, actions and evidence that might come from proactively “making the opposing case,” see the 2013 GPPC monograph for other examples). In areas or aspects of the audit where higher risk should lead to heightened professional skepticism, the IAASB should consider revising the wording in auditing standards to move beyond *confirming* management’s assertions to acknowledge instances when auditors should *challenge* management’s assertions and take skeptical action.<sup>7</sup> With respect to the auditor’s consideration of the effect of contrary evidence, we caution that the IAASB not to set an expectation that the auditor always needs to actively search for contrary evidence as part of developing an audit response.

We believe that a more complete and practical definition of professional skepticism along with enhanced application material will lead to an improved common understanding of the appropriate application of professional skepticism, which will help reduce the instances of insufficient professional skepticism in fact as well as false positives in inspection results.

***PS2. What do you believe are the drivers for, and impediments to, the appropriate application of professional skepticism? What role should we take to enhance those drivers and address those impediments? How should we prioritize the areas discussed in paragraph 37?***

The 2013 GPPC monograph covers many of the impediments and threats to the appropriate application of professional skepticism, as well as factors that mitigate the threats. In our response, we highlight some key points that we believe are particularly important to consider in revisions to the ISAs.

The different drivers, impediments, and enhancements to professional skepticism come into play at different structural levels (for example, individual auditor, engagement team, audit firm, and profession). Thus, to be effective, proposed enhancements must match the appropriate level with the impediments they are designed to address. For example, proposed solutions targeted at the

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<sup>6</sup> See a discussion of, and references to, judgment frameworks in the 2013 GPPC monograph. See also a professional judgment framework in a 2012 COSO monograph, “Enhancing Board Oversight: Avoiding Judgment Traps and Biases.” Both of these monographs also discuss some of the most important traps and biases that can impede the appropriate application of professional skepticism and judgment.

<sup>7</sup> Academic research suggests that revised wording in the standards can change the auditor’s “judgment frame” (i.e., confirming vs. challenging) and lead to more skeptical actions. In addition to changing the “framing” of wording, standards could in some cases require auditors to document their consideration of alternative explanations (e.g., similar to the opposing case considerations in a going concern assessment) and the evidence collected and evaluated to rule out these alternatives. See Maksymov, Nelson and Kinney, 2016, forthcoming *The Accounting Review*, *Effects of Procedure Frame, Procedure Verifiability, and Audit Efficiency Pressure on Planning Audits of Fair Values* ([http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2066160](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2066160)).

profession (such as mandatory firm rotation), may not effectively or completely address the impediments at the individual auditor level (such as personal traits or biases). Organizing potential impediments at the structural level will allow the IAASB to determine how standards can best address important concepts such as traits, biases, incentives, culture, and tone at the top. It will also help the IAASB to suggest ways other stakeholders can address potential impediments to enhance the application of professional skepticism.

With respect to tone at the top and incentives, engagement team leaders and firms need to understand the importance of recognizing and supporting the proper application of good judgment and skepticism (that is, skeptical effort and action) and not just outcomes (that is, finding a material misstatement or coming in under budget). A recent academic study finds that audit staff's skeptical behavior is evaluated based on whether the staff's investigation of an issue ultimately identifies a misstatement.<sup>8</sup> Holding staff judgments and acts constant across conditions, the study finds that evaluators penalized auditors who employ an appropriate level of skepticism, but do not identify a misstatement. In the majority of cases where the application of heightened professional skepticism is appropriate, the resulting additional effort and action will typically *not* result in the discovery of a misstatement. If the appropriate exercise of professional skepticism is recognized and supported only when the result is the identification of a misstatement, in many audit settings there may be insufficient incentive for individual auditors to properly link heightened risk with the appropriate application of professional judgment and skepticism. The points raised in this paragraph also have important quality control implications.

We believe that a significant impediment is the current vague and ambiguous definition of professional skepticism in the ISAs as outlined in our response to PS1. It is not particularly meaningful or helpful to encourage a staff auditor to be sure to apply (or document) appropriate "professional judgment" or "professional skepticism" if the best we can do is to provide ambiguous concepts and definitions. The addition of an improved definition with a framework and application material that links attitude and risk assessment, to action, evidence and documentation will help boost the professional skepticism and judgment abilities of staff auditors as they are able to identify and use actionable and understandable tools and techniques.

A top priority for the IAASB should be to continue to facilitate discussion with regulators and firms to see if there is agreement on the top root causes for the observed lack of professional skepticism in reported inspection findings. In terms of order of priority for the concepts address in paragraph 37 of the ITC, we rank those items as follows:

1. Clarifying and improving the definition of professional skepticism and related application material.

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<sup>8</sup> See Brazel, Jackson, Rech, Stewart, 2016, forthcoming in *The Accounting Review*, *The Outcome Effect and Professional Skepticism* (<http://ssrn.com/abstract=2349853>).

2. Clarifying and improving requirements and guidance in the ISAs to highlight areas and situations where it is particularly important or relevant to apply more professional skepticism.
3. Clarifying what actions and documentation are associated with situations where more or less professional skepticism is warranted.
4. Developing application material regarding what the evidence of the proper application of professional skepticism should look like in the work papers. In addressing these first 4 priorities, there will be an opportunity to include stakeholder's expectations about how professional skepticism should be applied and documented.
5. Develop and include frameworks for professional judgment and skepticism into the standards and application material. We believe frameworks will be key in accomplishing each of the first 4 priorities.
6. Clarify that drivers, impediments, and enhancements to professional skepticism differ by structural level, which means that drivers, mitigating factors, and enhancements need to be properly identified, evaluated, and aligned with the relevant structural level(s) in order to improve behavior and performance. This clarification will provide a place in the standards where the roles of the engagement partner, engagement quality control (EQC) reviewers, audit committees, audit oversight bodies, and others influence the appropriate application of professional skepticism. For example, with the clarifications noted above, an audit committee should be better equipped to engage with the auditor around identified risks and to reinforce and enhance the appropriate level of professional skepticism.
7. The role of technology and analysis tools (for example, data analytics) in professional skepticism; including how such tools affect the application of professional skepticism and in so doing impact the auditor's risk assessment and audit evidence to be obtained. We believe considerations relating to technology and tools would likely belong in application material to illustrate how professional skepticism may look, including the related skeptical actions and documentation. An improved definition, accepted frameworks, common understanding, and application material around the proper application of professional judgments will facilitate the design and development of tools, templates and technology to enhance the identification and tracking of situations that require heightened professional skepticism. For example, up-to-date databases housing electronic audit files combined with analyses at the firm level to benchmark across engagements and to third-party data might help firms monitor riskier areas and ensure proper audit responses and documentation.
8. Effective auditor training. If the ISAs can achieve the objectives and outcomes outlined above and in our response to PS1, it will improve the ability to develop training and hands-on application exercises to drive home a common understanding of what professional



skepticism looks like in terms of attitude, action, evidence and documentation across a continuum of risk situations.<sup>9</sup>

***PS3. Is the listing of areas being explored in paragraph 38–40 complete? If not, what other areas should we or the Joint Working Group consider and why? What do you think are the most important area to be considered?***

The areas in paragraph 38-40 are important and represent logical places to start the process of improving the application material around professional skepticism; however, we do not consider the areas listed to be complete as evidenced by our recommendations in PS1, PS2 and PS4. It is clear that a firm’s system of quality control is key to the proper application of professional skepticism at the specific engagement level. Similarly, often group audits and certain accounting estimates may represent areas where there is substantial judgment, complexity, and opportunity for management bias in the reported numbers. In areas that represent heightened risk, the IAASB can illustrate how to document audit procedures and evidence that demonstrates the appropriate application of professional skepticism. With respect to the auditor’s consideration of the effect of contrary evidence, we agree that this notion could be embedded more directly in the standards, but would caution the IAASB not to set an expectation that the auditor always needs to actively search for contrary evidence as part of developing an audit response.

***PS4. Do you believe the possible actions we might take in the context of our current projects relating to quality control and group audits will be effective in promoting improved application of professional skepticism? If not, why?***

Yes, in the short-term these areas are a good place to start—particularly as the IAASB considers a more complete and practical definition of professional skepticism. The revised application material drafted for these projects may include guidance on obtaining and documenting evidence in a way that demonstrates the appropriate application of professional skepticism. For example, the application material could illustrate in an area of heightened risk that it may be appropriate to specifically consider alternative explanations for a reported outcome. It is helpful that the IAASB also has projects on auditing estimates and risk assessment that will also be important in the consideration of further addressing professional skepticism in potential revisions to those standards.

***PS5. What actions should others take to address the factors that inhibit the application of professional skepticism and the actions needed to mitigate them (e.g., the IAESB, the IESBA, other international standards setters or NSS, those charged with governance (including audit committee members), firms, or professional accountancy organizations)? Are there activities already completed or underway of which we and the Joint Working Group should be aware?***

We are very pleased that the IAASB recognizes the importance of other parties in achieving an appropriate application of professional skepticism in the financial reporting process. While the responsibility of the IAASB is focused on auditors and to a certain extent firms, any approach to enhancing professional skepticism that omits the role of other key parties—such as management,

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<sup>9</sup> The 2013 GPPC monograph provides several potentially fruitful areas to improved training.

audit committees, regulators and other standard setters—will be incomplete and less effective. We point the IAASB to the section, “What can other Stakeholders in the Financial Reporting Process do to Enhance Professional Skepticism” in the 2013 GPPC monograph for additional thoughts and recommendations in this regard.

## **Quality Control**

***QC1. We support a broader revision of ISQC 1 to include the use of a QMA as described in paragraphs 45–67.***

- (a) Would use of a QMA help to improve audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate this approach?***
- (b) If ISQC 1 is restructured to require the firm’s use of a QMA, in light of the objective of a QMA and the possible elements described in paragraphs 64 and Table 3, are there other elements that should be included? If so, what are they?***
- (c) In your view, how might a change to restructure ISQC 1 impact the ISAs, including those addressing quality control at the engagement level?***
- (d) If ISQC 1 is not restructured to require the firm’s use of a QMA, do you believe that we should otherwise address the matters described in paragraph 59 and table 2, and if so, how?***

We believe that the application of a QMA could enhance a firm’s approach to evaluating its quality control system; however without an example for at least one element of how the QMA principle would be adopted, it is unclear how this approach will be different than the application of the current QC standards. Paragraph 54 of the ITC states, in part, “While retaining robust requirements, incorporation of a QMA ...”. We note that the concept of “retaining” refers to the robustness of the requirements, and hope it is not intended to imply that each existing requirement will be retained regardless of whether the QMA makes it redundant. We support incorporating a QMA as a general principle underlying the firm’s approach to its Quality Control (QC) systems and policies and procedures. Application material that illustrates how a firm might take such a holistic approach to designing a QC system responsive to its risks and embedding quality throughout would be helpful, as would ample guidance on how a QMA could be incorporated, including examples of the types of risks and how to objectively identify them. We believe this would be especially helpful for Small Medium Practitioners (SMPs).

If ISQC 1 is not restructured to adopt a QMA approach, we support addressing the matters described in paragraph 59 and table 2 through implementation guidance that clearly spells out what is expected in applying the requirements.

***QC2. Engagement Partner Roles and Responsibilities***

- (a) Paragraphs 69–86 set out matters relating to the roles and responsibilities of the engagement partner.***

*(i) Which of the actions outlined in paragraphs 85–86 would be most meaningful to address issues related to engagement partner responsibilities?*

*(ii) Why do you believe these actions are necessary?*

*(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*

*(iv) Describe any potential consequences of possible actions that you believe we need to consider further.*

*(b) Do you think it is necessary for the ISAs to include requirements or otherwise address the circumstances described in paragraph 79 in which an individual other than the engagement partner is required to or otherwise customarily sign(s) the auditor's report or is named therein? If yes, please explain why, and provide your views about how this could be done (including describing the work effort you believe would be necessary for such an individual).*

As an overarching comment to all the questions in (a) above, we believe that it is preferable to add application material and provide more implementation guidance than to make the requirements more prescriptive. The more prescriptive the requirements, the harder it is to make the requirements scalable for smaller firms. In addition, application material is necessary to address the needs of sole practitioners when considering requirements for engagement review.

ISA 230, *Audit Documentation*, addresses documentation; any additional specificity on audit documentation with regard to the engagement partner would be more appropriately placed there than in ISA 220, *Quality Control for an Audit of Financial Statements*.

With respect to question in subparagraph (b), this seems more like a regulatory issue and risk management, not an issue to be addressed through the standards. It may be helpful, however, to clarify the distinction between the engagement partner (that is, the person who is responsible for the report that is issued on behalf of the firm) and the person who signs the report on behalf of the firm, (as in many jurisdictions these are required or expected to be the same person). Guidance that the responsibilities of the engagement partner are not diminished when the engagement partner is not the person who signs the report may be helpful.

### ***QC3. Others Involved in the Audit***

*(a) Paragraphs 87–104 set out matters relating to involvement of others in the audit:*

*(i) Which of the actions outlined in paragraphs 100–104 would be most meaningful to address issues related to others participating in the audit?*

*(ii) Why do you believe these actions are necessary?*

*(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*

*(iv) Describe any potential consequences of possible actions that you believe we need to consider further.*

*(b) Should we develop further requirements or application material for circumstances when other auditors are involved in an audit engagement (i.e., auditors that don't meet the definition of component auditors)?*

With respect to the questions in subparagraph (a), we agree with exploring the possibility of making reference. We believe that referring to the report of another auditor adds transparency about the source of audit evidence. If the auditor does not have the ability to be involved in the work of a component auditor, the only option available under the ISAs is to treat this as a scope limitation and modify the opinion. We believe that making reference is a better option that provides more information to the users of the financial statements.

Because the engagement team cannot rely on the other firm's system of quality control when assessing the professional competence and capability of other auditors, additional application material regarding this may be helpful.

In regard to expanding the auditor's report to say more about the nature and extent of involvement of others in the audit, including component auditors, other auditors, and auditor's experts, the disclosure of other auditors was specifically considered and not pursued in the IAASB's due process leading up to the issuance of the new and revised ISAs on auditor reporting. Any further enhancements to the auditor's report should be considered in conjunction with the IAASB's planned post-implementation review in order to evaluate any potential enhancements in a holistic and prioritized manner.

The benefit in disclosing the involvement of others in the audit lies in the meaningfulness of the information to the user of the auditor's report. We believe that meaningful disclosure in this regard relates to information about the *source* of audit evidence; listing component auditors, other audits and auditor's experts would provide information about those involved in the *process* of obtaining audit evidence. While it might emphasize that the "auditor" is really a team, we are concerned of the potential negative consequence of diffusing the firm's responsibility for the audit. While disclosing that the firm used an international network firm for a substantial part of the audit may be of interest to users, disclosing that other auditors were involved in performing, for example, inventory observation is comparable to listing the names of experienced per-diem personnel on the audit team, which does not seem to be especially meaningful information.

With respect to question in subparagraph (b), we strongly believe that additional application material is needed to address circumstances when other auditors that do not meet the definition of component auditors are involved in an audit engagement. Matters that could be addressed including understanding the other auditor and involvement in the work of the other auditor. In

addition, application material that addresses the component auditor's responsibility to respond to the group auditor would be helpful.

***QC4. The Firms' Role in Supporting Quality***

***(a) Paragraphs 106–123 set out matters relating to networks of firms and use of ADMs.***

***(i) Which of the actions outlined in paragraphs 114–116 and 122–123 would be most meaningful to address issues related to firms operating as part of a network of firms and firms' changing business models and structures?***

***(ii) Why do you believe these actions are necessary?***

***(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

***(iv) Describe any potential consequences of possible actions that you believe we need to consider further.***

***(b) Specifically:***

***(i) What could we do to address the issues identified in the context of networks of firms? For example, should we develop more detailed requirements and application material to address reliance on network-level policies and procedures at a firm or engagement level?***

***(ii) Do you think it would be feasible for us to develop requirements and guidance for networks? Please provide a basis for your views.***

***(iii) Paragraphs 117–123 set out matters relating to the use of ADMs and related issues.***

***a. How should our standards emphasize the importance of appropriate quality control processes in relation to use of ADMs?***

***b. Are you aware of ADMs that raise issues not discussed in paragraphs? If so, please provide details.***

With respect to the questions in subparagraph (a), we reiterate our belief that it is preferable to add application material and provide more implementation guidance than to make the requirements more prescriptive. We recommend more explicitly addressing through such guidance what to consider in assessing the network's system of quality control. Both at the firm level and at the engagement level, there needs to be an understanding of the network's controls and any deficiencies or issues with those controls so that the firm and engagement partners can determine whether to

rely on that system or whether there is a need to develop additional procedures. We note that this is equally true in larger firms with multiple offices.

With respect to the questions in subparagraph (b), we do not believe that it is feasible to develop requirements and guidance for networks given the diversity of network arrangements.

Regarding ADMs, even in firms that do not have such arrangements there is an increasing tendency to perform procedures remotely because so much of the evidence is available electronically and firms, to a great extent, maintain their engagement documentation in an electronic format. Even in small firms, many audit procedures no longer require any face-to-face interaction with management, or even client personnel. We support the recommendations in paragraph 123 to address these situations, as additional application material, and would stress the overall consideration of whether appropriate supervision and review can be effectively applied in certain circumstances and audit areas. Suggestions for application material include the importance of making a site visit in connection with an assurance engagement because so much can be learned through observation and face-to-face interaction with the client. Alternatively, firms are exploring the use of video-meeting technology to make “virtual” site visits and to conduct “face-to-face but not in-person” conversations.

***QC5. Governance of the Firm, Including Leadership Responsibilities for Quality***

***(a) Paragraphs 125–135 set out matters relating to governance of firms, including leadership responsibilities for quality.***

***(i) Which of the possible actions outlined in paragraphs 131–135 would be most meaningful in addressing issues related to firm governance and leadership responsibility for quality?***

***(ii) Why do you believe these actions are necessary?***

***(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

***(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.***

***(b) Specifically:***

***(i) Do you believe it is necessary for us to explore how the governance of a firm could be addressed in ISQC 1?***

***(ii) 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?***

*(iii) Would the use by firms of a QMA 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?*

We agree with firm leadership taking responsibility, setting the appropriate tone at the top, and leading by example, and we agree with putting these concepts and words in ISQC1. We are concerned about being overly prescriptive; it is important to remember in this context both the importance of firm leadership setting an appropriate culture and that the objective of a firm's system of quality control is to obtain reasonable, not absolute, assurance.

We recommend adding application material stressing the importance of leadership at every level taking responsibility for quality: at the firm level, at the practice office or practice unit level, and at the engagement level.

As noted above, without specific examples it is difficult to determine whether a QMA would better support quality, or would just be an additional layer of procedures that adds minimum value.

***QC6. Engagement Quality Control Reviews and Engagement Quality Control Reviewers***

*(a) Paragraphs 136–146 set out matters relating to engagement quality control reviews and engagement quality control reviewers.*

*(i) Which of the possible actions outlined in paragraphs 143–146 would be most meaningful in addressing issues related to EQC reviews and EQC reviewers?*

*(ii) Why do you believe these actions are necessary?*

*(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*

*(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.*

*(b) Specifically:*

*(i) Should ISQC 1 mandate the performance of EQC reviews beyond audits of listed entities? If yes, what other entities should be considered and how could we best define these entities? If no, please explain your reasoning.*

*(ii) Do you believe it is necessary for ISQC 1 to require 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 serve as the EQC reviewer on the same engagement?*

*If yes, how do you think this should be done and why? If no, please explain why.*

**(iii) Would you support the development of a separate EQC review standard? Please explain the reasoning for your response.**

With respect to the questions in subparagraph (a), we believe, based on monitoring of the implementation of the ASB's Statement on Quality Control Standard No. 8, *A Firm's System of Quality Control*, which is converged with ISQC1, that the requirement in paragraph 35b of ISQC1 to set out criteria for determining when an EQC review is to be performed should be strengthened to require that the criteria be based on the firm's identified risks related to its engagements. Paragraph A41 of SCQC No. 8 has application material that states that the structure and nature of the firm's practice are important considerations for establishing which engagements are to be subject to an EQC review. This application material goes further than the application material in ISQC 1; based on implementation monitoring, we recommend that rather than strengthening the application material this guidance be elevated to a requirement. Application material could be added emphasizing that as a firm's practice evolves, the criteria for when an EQC review is required may need to be revised.

We have no objections to strengthening the documentation requirements in ISA 220 as described. Likewise, we support adding application material that clarifies the use of subject-matter experts to assist the EQC reviewer. Given the increasing complexity of accounting standards along with heightened focus on audit quality, we believe it is imperative that the EQC reviewers consider the need for assistance in their reviews to effect a timely and meaningful assessment of the audit risks and responses. With regard to additional specificity around the nature and extent of matters to be considered by the EQC reviewer, we support additional application material if considered necessary to address disparities in practice; we do not support additional requirements as the circumstances and judgments as to significant risks varies depending on the engagement circumstances.

We suggest that additional guidance be provided on the extent to which an EQC reviewer can be consulted during an engagement without compromising the reviewer's objectivity. We strongly believe earlier involvement and engagement of the EQC reviewer leads to improved audit quality. Guidance on the resolution of disagreements between the EQC reviewer and the engagement team would also be helpful.

With respect to the questions in subparagraph (b), we have concerns about expanding the types of engagements that would require an EQC review beyond audits of listed entities. Firms may specialize in an industry or area and requiring that all engagements in that industry or area be subject to EQC review is overly prescriptive and does not recognize the varying degree of risks to the firm of those engagements. In addition, we believe that the difficulty in defining entities of particular public interest makes this impracticable. However, as mentioned above, we support strengthening the requirement in paragraph 35b to require that the criteria be based on the firm's identified risks related to its engagements and enhancing the application material in paragraph A41 to be more specific about such risks, for example, entities subject to regulatory oversight.



We do not support a requirement for a defined “cooling-off” period between serving as engagement partner and serving as EQC reviewer. While we agree that serving as engagement partner one year and EQC reviewer the next is far from optimal, the focus should be on the EQC reviewer’s ability to be objective. Requiring a minimum period would result in a focus on the “rule” and diminish the consideration of objectivity. We are also concerned about the impact of this requirement on SMPs. Finding EQC reviewers is more difficult for smaller practitioners and relatively speaking more costly. A “cooling-off period” would only increase the difficulty. If the IAASB decides to mandate a “cooling-off period,” it should be structured to vary based on the size of the firm, the number of audits performed or other pertinent criteria.

We do not support the development of a separate EQC standard. We believe that the requirements in ISQC1 regarding EQC review are not deficient and a separate standard is not warranted. We agree with all the disadvantages listed and believe that they outweigh the advantages. A separate standard will place undue emphasis on an EQC review, which is only one quality control measure. A separate standard would give the impression that the EQC reviewer’s responsibility for the engagement is equal to that of the engagement partner’s, if not more so. To this point, we agree that clarification of the role of the EQC reviewer in relation to the engagement partner would be helpful. As discussed in our response to QC11, we support further clarification about the role of an EQC review and its relationship with other reviews and monitoring procedures.

We oppose a requirement for the engagement partner to communicate with those charged with governance that an engagement is subject to an EQC review. The potential for misunderstanding is very high. Why should this one quality control measure, internal to the firm, be communicated when no other of the firm’s processes and procedures, such as other reviews that the engagement is subject to, are communicated? We also oppose any requirement for communication between the EQC reviewer and those charged with governance. The potential for misunderstanding the EQC reviewer’s role on the engagement is extremely high, as well as the potential for giving the impression that the EQC reviewer’s responsibility for the engagement is higher than that of the engagement partner.

***QC7. Monitoring and Remediation***

- (a) Paragraphs 147–159 set out matters relating to monitoring and remediation.***
  - (i) Which of the possible actions outlined in paragraphs 156–159 would be most meaningful in addressing issues related to monitoring and remediation?***
  - (ii) Why do you believe these actions are necessary?***
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.***

**(b) Specifically:**

**(i) 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 inspection findings and other reviews? If not, why? Are there any potential consequences or other challenges of taking this action that you believe we need to consider?**

**(ii) Do you support the incorporation of a new requirement(s) 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.**

With respect to the questions in subparagraph (a), we support all the recommendations suggested in paragraph 156, with an emphasis on new application material rather than on strengthened requirements. While the logical order of the requirements in ISQC1 regarding monitoring and remediation can be discerned on careful reading, this section could benefit from additional clarification.

The suggestion in paragraph 158 of the ITC of firm leadership monitoring of the effectiveness and appropriateness of remedial actions would be a meaningful action to address issues related to monitoring and remediation. Sometimes remediation is focused more on the specific engagement deficiencies identified instead of evaluating the deficiencies in the context of whether there is an overall firm issue. (For example, is the issue systemic, a tone at the top issue, a firm structural issue, a resource management issue, a policy issue, a training issue, a personnel issue, etc.?) Having firm leadership involved in this process would help ensure that the remediation is actually meaningful and that the deficiencies are not repeated in the next inspection cycle.

With respect to the question in subparagraph (b):

(i) We recommend that the IAASB engage with stakeholders to collect views on what comprises effective root cause analysis. This outreach would help the IAASB determine whether to introduce such a requirement into ISQC 1. In addition, this outreach would help to develop supporting application material. Without ample guidance, the risk exists that the root cause analysis will become a perfunctory exercise intended to meet the letter but not the spirit of the requirement. We believe that while obtaining an understanding of the causal factors of audit deficiencies is helpful, root cause analysis is a means to an end (remediation), and not the end itself. We recommend that as the IAASB further considers this action, the focus be on developing appropriate corrective measures, at the appropriate level, aimed at preventing recurrence of the deficiencies.

(ii) We support the proposed requirement 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. Consideration might be given to the usefulness of an annual assertion by firm's leadership regarding the effectiveness of the firm's system of quality control.

***QC8. Engagement Partner Performance and Rewards Systems***

***Paragraphs 160–170 set out matters relating to engagement partner performance and rewards systems.***

- (a) ***Do you believe that establishing a link between compensation and quality in ISQC 1 would enhance audit quality? Why or why not?***
- (b) ***What actions (if any) do you believe we should take in this regard? Are there potential consequences of possible actions that you believe we need to consider?***

We strongly agree with the IAASB that ISQC 1 should not be used as a vehicle to mandate the structure of an engagement partner's remuneration, neither 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 nor in any other regard.

We are concerned that incentives to address audit quality could have the unintended consequence of giving the impression that forgoing the incentive through delivering lower quality is an acceptable viable option (that is, it may lower the baseline of what is considered acceptable quality). The highest level of audit quality should always be the goal.

We agree that ISQC1 could seek to address the linkage between compensation and audit quality, although as audit quality is only one of many factors that should be considered as part of a remuneration structure, the linkage is difficult to draw. Examples would be useful. We note that for sole practitioners, there is no way to tie compensation to quality in any meaningful way.

***QC9. Human Resources and Engagement Partner Competency***

(a) ***Paragraphs 171–187 set out matters relating to human resources and engagement partner competency.***

(i) ***Which of the possible actions outlined in paragraphs 176–178 and 187 would be most meaningful in addressing issues relating to human resources and engagement partner competency?***

(ii) ***Why do you believe these actions are necessary?***

(iii) ***Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

(iv) ***Please also describe any potential consequences of possible actions that you believe we need to consider further.***

(b) ***Specifically, which of the possible actions outlined, or other actions not described, in paragraphs 176–178 and 187 would most positively impact audit quality:***

- (i) Arising from issues related to knowledge, skills, competence and availability of a firm's partners and staff?*
- (ii) Related to engagement partner competency?*
- (iii) Why do you believe these actions are necessary? If you would not support a particular action, please explain why, including any potential consequences of those actions that you believe we need to consider.*

Of the actions described in paragraphs 176-178, we strongly support the inclusion of continuity planning in the context described. This is an important concept and the inclusion would strengthen a firm's system of quality control.

With regard to the actions described in paragraph 187, we have no objections. We reiterate our support for expanding application material rather than requirements, and we urge the IAASB to write the application material in "plain English." We are concerned about excessive inclusion of material from IES 8; perhaps application material that reminds firms of the need to be familiar with IES 8 would suffice.

Paragraph 174 of the ITC discusses performance evaluations of staff by SMPs. We agree that SMPs would not require formal documentation requirements for staff.

#### **QC10. Transparency Reporting**

*Paragraphs 188–190 set out matters relating to transparency reporting.*

- (a) Do you believe we are able to positively contribute to the evolving developments related to transparency reporting? If so, what, in your view, would be the most appropriate action we could take at this time?*
- (b) If you would not support us taking actions as described in paragraph 190(b), please explain why, including any potential consequences of those actions that you believe we need to consider.*

We believe that it is premature for the IAASB to take action regarding transparency reporting as the area is evolving.

We note that in considering transparency reporting, the IAASB will need to address privacy concerns for SMPs. For sole practitioners, there is no distinction between their firm and themselves; details about the firm can be directly attributed to the practitioner personally. That can lead to private information being publicized, which is a problem for safety or security reasons. Also, with a small client base compared to other firms, anything that is client metric-driven might allow others to surmise client identities, since there is not as much audit data to aggregate.

*QC11. Are there any other issues relating to quality control that we have not identified? If yes, please provide details. What actions should we take to address these issues?*

Based on our monitoring of implementation issues in our jurisdiction, we believe that there is much confusion about monitoring. The roles of, and distinctions between, pre-issuance reviews, post-issuance reviews, and EQC reviews are not defined in professional literature. It is not well understood in practice the extent to which these reviews are intended to improve engagement quality as compared to improving system quality. An explanation of how a review protocol could be adopted, and how each review relates to monitoring, with examples of such a program, would bring clarity and drive consistency in practice.

***QC13. Are there any specific considerations for SMPs related to the issues and potential actions described in this section? Are there any other considerations for SMPs of which we should be aware? If so, please provide details and views about these matters.***

We strongly support additional considerations for SMPs, including more robust application material to assist SMPs in implementing the requirements of ISQC1 as noted in our opening comments. An area that can be clarified is how to implement ISQC1 when a firm's practice does not include any audits, especially with regard to the element of engagement performance. ISQC1 needs to be flexible and scalable to accommodate the needs of various firms, recognizing however that meeting some requirements of ISQC1 will be harder for SMPs, as they have with fewer resources; regardless, this does not absolve them from the obligation to comply with the requirements.

If the QMA is adopted, we believe that implementation material with examples that provide risks and approaches specific to SMPs will be necessary.

### **Group Audits**

***GAI. We plan to revise ISA 600 (and other standards as appropriate) to respond to issues with group audits.***

- (a) Should we increase the emphasis in ISA 600 on the need to apply all relevant ISAs in an audit of group financial statements? Will doing so help to achieve the flexibility that is needed to allow for ISA 600 to be more broadly applied and in a wide range of circumstances (see paragraphs 194–198)? If not, please explain why. What else could we do to address the issues set out in this consultation?***
- (b) Would the actions we are exploring in relation to ISA 600 improve the quality of group audits? If not, why?***
- (c) Should we further explore making reference to another auditor in an auditor's report? If yes, how does this impact the auditor's work effort?***
- (d) What else could the IAASB do to address the issues highlighted or other issues of which you are aware? Why do these actions need priority attention?***

We agree with the IAASBs efforts to address issues with the group audit standard. We have highlighted certain overarching observations, views, and recommendations with respect to the standard and how it should be applied in the following paragraphs.

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May 16, 2016

(a) The financial information of components and the consolidation process are elements of group financial statements, not the entirety, so we agree with emphasizing that all relevant ISAs apply, but as noted in our comments below terms such as “audit” of the component have been confusing and should be clarified.

(b) ISA 600 has an implicit view of a group as comprising components that are vertically consolidated and that there is a certain degree of control by the group entity. However, there are situations that do not fit that model, such as shared service centers or equity method investments. Our response focuses on a belief that ISA 600 should address, in one standard, the requirements when other auditors are involved in the audit (irrespective of whether the audit meets the definition of “group audit”), and appropriately responding to the risks of material misstatement in such situations.

We believe that ISA 600 should provide requirements and application material on how an auditor, to obtain sufficient appropriate audit evidence, uses the work of other auditors in situations that include one or more of the following:

- Multiple locations (i.e. shared service centers)
- Consolidated entities
- Equity method investments
- Fair value measurements

It would seem logical to presume that using the work of another auditor as evidence should have same implications regardless of the accounting principles applied; however, currently the auditing requirements differ based on the accounting method. Consider the following examples:

- A fund accounts for its underlying investment funds based on net asset value—In most instances, the investment is between 1 and 3 percent of the fund and the reporting entity cannot exert influence over the operations of the investment funds. Many have different year ends. The number of investments aggregates to a material amount. Some practitioners believe that these equity investments are, by current definition, “components” (and there is aggregation risk), ISA 600 applies, and the auditor is required to evaluate whether to communicate with all or any of the components.
- Same general facts but the investments are accounted for at fair value—The investment is not considered a component, and there is no requirement for any communication with the component auditor.
- Two entities—one has investments at fair value, the other at equity—same materiality—The auditor of one has to comply with group standard, including independence; the auditor of the other does not, even though the principal evidence—the audit report—is the same.

Ms. Kathleen Healy  
May 16, 2016

Consideration of these types of scenarios in revising ISA 600 would be most helpful. To the extent the focus remains on groups and components, we recommend considering a revised definition of a component to acknowledge the different structures discussed above.

Concern has been expressed that the current standard requires certain procedures when financially significant components exist, and if the auditor chooses to obtain sufficient appropriate audit evidence through other means, the auditor is required to document that alternate procedures were performed. For example, the group auditor may choose to accumulate sufficient appropriate audit evidence through a combination of other audit procedures such as detailed testing by the group auditor, confirmation, analytics, reliance on a SOC report, or agreed-upon or specified procedures. While these procedures are required to be documented, documenting that these were performed as alternate procedures and the justification for performing these instead of the others required by ISA 600 is cumbersome. We recommend revising ISA 600 to be less prescriptive and allow flexibility in the methods of obtaining sufficient appropriate audit evidence.

(c) We not only agree with the further exploration of making reference to another auditor in the auditor's report; we support providing the ability to make reference. When the auditor is unable to assume responsibility for the work of the component auditor, due to access or other issues, the only option under ISA 600 is to modify the opinion. This outcome is not acceptable in all jurisdictions. In addition, in certain situations, such as large merger and acquisition transactions that occur late in the year, or with respect to non-controlled entities which, as noted in the response to GA13 below, is common in governments, the ability to assume responsibility may not be practical. In jurisdictions, such as the United States, where making reference is acceptable, actual usage of the ability to do so is very limited to challenging situations such as these. Making reference is a viable alternative that provides useful information to the capital markets. We believe that making reference provides transparency about the source of the audit evidence with respect to those components for which reference to the audit of component auditors is made. Consideration may be given for auditor's reports for listed entities to include, in the same spirit of transparency that requires Key Audit Matters (KAM) and partner signatures, the names of the firms that participate in the audit based on total hours, akin to the Public Company Accounting Oversight Board Form AP, *Auditor Reporting of Certain Audit Participants*.

(d) We do not recommend a separate standard for component auditors as we believe the current model can, with appropriate revision, address the concerns raised in the post-implementation review. We believe the standards should be revised to address more clearly and distinctly when the audit is of a group, when the audit involves other auditors, and when the auditor is making reference to the report of a component auditor (if that notion is adopted.)

## ***GA2. Acceptance and Continuance of the Group Audit Engagement***

***(a) Paragraphs 204–217 set out matters relating to acceptance and continuance of the group audit engagement.***

***(i) Which of the possible actions outlined in paragraphs 215–217 would be most meaningful in addressing issues related to acceptance and continuance procedures?***

*(ii) Why do you believe these actions are necessary?*

*(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*

*(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.*

*(b) Specifically:*

*(i) Are access issues as described in paragraph 207(a) still frequently being experienced in practice? If yes, please provide details and, where possible, explain how these are being addressed today.*

*(ii) Do you agree that ISA 600 can or should be strengthened in relation to addressing access issues as part of acceptance and continuance?*

*(iii) Would expanding the understanding required for acceptance and continuance, as described in paragraph 215 (b), be achievable in the case of a new audit engagement?*

In practice, issues of access can be distinguished between access necessary for auditor involvement, supervision and review, and issues of access to complete documentation. With regard to the former, in the age of technology, the meaning of access may be different. We recommend focusing on what is necessary to obtain sufficient appropriate audit evidence while performing appropriate supervisory and review procedures. Additional application material on the extent of involvement necessary to be able to serve as engagement partner would be helpful.

Access to issues that relate to documentation may be more difficult to resolve. Jurisdictions may not allow foreign auditors the same degree of access available to management or to native auditors. Foreign auditors may have access to the evidence, but be limited in what they are allowed to include in the group audit documentation maintained out of the jurisdiction. Regulators in the parent jurisdiction often are not satisfied with the audit documentation in such situations (perhaps due to a different understanding of the standards?) While not accepting the engagement is an option, that option does not support effective functioning of the capital markets and as such we do not believe that this option should be viewed as the appropriate way forward when presented with such issues.

Another issue to be considered in acceptance and continuance is the fact that not all components that ultimately need to be reported on may be known at engagement acceptance. The entity may have a late-in-the-year acquisition of an equity investment or business whose auditors have otherwise planned or executed the audit without consideration of the group.

### ***GA3. Communications between the Group Engagement Team and Component Auditors***



***(a) Paragraphs 218–225 set out matters relating to communications between the group engagement team and component auditors.***

***(i) Which of the possible actions outlined in paragraph 224 would be most meaningful in addressing issues relating to communication between the group engagement team and the component auditor?***

***(ii) Why do you believe these actions are necessary?***

***(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why?***

***(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.***

We agree with the possible actions described in paragraph 224 to address the issues identified with respect to communication. As noted above, we do not recommend a separate standard for component auditors. Instead, we support expanding ISA 600 to address requirements for when auditors work together, regardless of whether as group or component auditors. Requirements should be flexible to fit the circumstances; for example, when a new equity investment or change in ownership late in the year makes communication before the other auditors have begun planning or performing their work impractical or impossible.

We believe the standards could facilitate better communication. We support enhanced application material that clarifies the expectations for communication by the component auditor and includes examples of different kinds of communications that may be appropriate in different circumstances. For example, firms acting as component auditors have received requests for interfirm reporting despite not being part of the firm acting as group auditor, or even part of that firm's network. The situation of a group auditor sending incomplete or incorrect instructions is an implementation issue that may not need to be addressed in the standard, but we ask the IAASB to consider other means of addressing, including application material on the dialogue between the component auditor and group auditor from the component auditor perspective. In addition, we struggle with the "pen pal" approach; application material that encourages more "live" interaction, such as oral dialogue (rather email or other virtual means), would be helpful, but we would not mandate discussions in all circumstances. Likewise, application material on the communication of KAM between the group and component auditors would be helpful.

There is diversity in practice on reporting final conclusions between component auditors and group auditors. Some group auditors will provide illustrative letters for the component auditor to fill in the blanks, sign, and return. However, the language in those illustrative letters is not always acceptable to the component auditor and a negotiation process begins. Illustrative reporting language in the standards or a list of minimum elements in the report would be helpful. In addition, application material on how to report when the component auditor has done less than a full audit, such as specified audit procedures, is needed. Further application material on the engagement partner's responsibility to review or validate the information provided pursuant to the requirement

in par. 41 would be helpful. Under the current standard, the group auditor's responsibility to verify that that a component auditor has responded to risks identified by the group auditor is not explicit.

**GA4. *Using the Work of the Component Auditors***

**(a) *Paragraphs 226–242 set out matters relating to using the work of the component auditors.***

**(i) *Which of the possible actions outlined in paragraph 234 and 242 would be most meaningful in addressing issues related to using the work of the component auditor?***

**(ii) *Why do you believe these actions are necessary?***

**(iii) *Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

**(iv) *Please also describe any potential consequences of possible actions that you believe we need to consider further.***

**(b) *Specifically:***

**(i) *Should the nature, timing and extent of involvement of the group engagement team in the work of the component auditor vary depending on the circumstances? If yes, how could changes to the standard best achieve this objective?***

**(ii) *Should ISA 600 be strengthened to require the group engagement partner to make an explicit determination about whether the group engagement team can use the work of a potential component auditor?***

We believe the nature, timing, and extent of involvement of the group engagement team with the work of the component auditor should vary depending on the circumstances. There are both similarities and differences in using a specialist and using the work of a component auditor. Another auditor is assumed to have the same knowledge and skills; using the work of a component auditor may be compared to using an assurance report on controls at a service organization under ISAE 3402, *Assurance Reports on Controls at a Service Organization*. We recommend that the IAASB explore the comparability and relationship in the ISAs of all parties whose work is used by the auditor to ensure a consistent approach is used in evaluating audit evidence from third parties, as appropriate.

With regard to independence, practice is inconsistent as to whether independence is required at the group level or only at the component jurisdictional level; that is, does the component auditor need to be independent with respect to the group or only the component? Does the materiality of the component matter in this regard? We suggest that in conjunction with the IAASB's considerations

regarding the ability to use the component auditor's work, the IAASB develop a list of issues for IESBA consideration similar to the example we have highlighted.

**GA5. *Identifying and Assessing the Risks of Material Misstatement in a Group Audit***

**(a) *Paragraphs 243–253 set out matters relating to identifying and assessing significant risks in a group audit:***

**(i) *Which of the possible actions outlined in paragraphs 251–253 would be most meaningful to address issues relating to identifying significant risks for the group audit?***

**(ii) *Why do you believe these actions are necessary?***

**(iii) *Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

**(iv) *Please also describe any potential consequences of possible actions that you believe we need to consider further.***

We agree with the possible actions suggested to address the issues, including the proposal to enhance ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*. Two-way communication is essential in every audit but takes on greater significance in a group audit situation. Group auditor and component auditor should work together to coordinate risk assessment, rather than having the group auditor dictate instructions with no input from the component auditor. Guidance for the component auditor would be helpful to address situations such as

- Inappropriate instructions are received from the group auditor based on their faulty understanding of the component.
- Whether evidence obtained from the group auditor regarding a receivable from the parent to the component is independent evidence.
- The component auditor's reporting obligations when the component auditor becomes aware of material risks at the group level not applicable to the component.
- Situations where the group auditor is taking audit responsibility for certain financial statement accounts or assertions of the component.

We also agree with the issues and possible actions identified with regard to the use of shared service centers in group audits.

**GA6. *Issues Relating to Component Materiality and Other Aspects of Materiality Relevant to Group Audits***

*(a) Paragraphs 254–261 set out issues relating to applying the concept of materiality in a group audit. Do you agree with the possible actions recommended in paragraph 261 to clarify the different aspects of materiality in a group audit? If not, please indicate which actions are not appropriate and describe why.*

*(b) 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.*

Materiality with respect to the component is used to address aggregation risk, evaluate misstatements at the component level, and evaluate misstatements at the group level. It is important to clarify the relationship between materiality calculated in accordance with ISA 320, *Materiality in Planning and Performing an Audit*, used to evaluate misstatements, and component materiality calculated in accordance with ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, set to address aggregation risk. Materiality at the component – that is, the materiality used for purposes of the component’s standalone financial statements – is used to evaluate misstatements at the component level and is set by the component auditor in accordance with ISA 320. Component materiality is set by the group auditor in accordance with ISA 600 to deal with aggregation risk. The amounts may or may not be the same, but the purpose of each is distinct. This distinction is not well-understood in practice, and we believe clarification cannot wait for a review of ISA 320. Aggregation risk is not well-understood in practice, as discussed in paragraph 255 of the ITC: Regulators and audit oversight bodies have noted instances where component materiality has been established at 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. These issues are common in situations when only one audit firm is involved, but components are present. Additional guidance and its related practical impacts on other audit judgments would be helpful.

Practice is unclear on whether the component auditor can use component materiality for financial statements materiality if the only user of the financial statements is the group auditor. For example, what is the impact if the component is a wholly-owned subsidiary? In addition, the standard is unclear as to the purpose of component materiality when there is no separate stand-alone audit of the component’s financial statements or only a single firm is involved.

The auditing standards of the ASB permit making reference; implementation issues exist with regard to materiality and the group auditor’s responsibility for materiality considerations and uncorrected misstatements at the component level when making reference. While the group auditor considers component materiality when making reference, it is not responsible for determining component materiality, which raises questions as to how the consideration should be applied in practice and its impact on communications between the group and component auditors. As a result, if the IAASB expands ISA 600 to permit making reference, it should consider expanded guidance in this area.

**GA7. Responding to Identified Risks of Material Misstatement in a Group Audit (Including Issues Relating to the Group Engagement Team's Involvement in the Consolidation Process)**

**(a) Paragraphs 262–292 set out matters relating to responding to identified risk of material misstatement in a group audit (including the group engagement team's involvement in the consolidation process).**

**(i) Which of the actions outlined in paragraphs 272–273, 279, 288 and 292 would be most meaningful to address issues relating to responding to identified risks of material misstatement in a group audit?**

**(ii) Why do you believe these actions are necessary?**

**(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**

**(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.**

**(b) Specifically:**

**(i) 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 we need to consider further?**

**(ii) Are there other possible actions related to auditing groups where there are a large number of non-significant components that we should explore? Are there other approaches to auditing such groups that need to be considered? Do the possible actions presented lead to any additional practical challenges?**

**(iii) 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?**

**(iv) Should the requirements or application material relating to subsequent event procedures be strengthened or clarified? Are there further issues or practical challenges that have not been considered?**

ISA 600 is focused on group financial statements; however the purpose of classifying components as significant or not is unclear. We agree that it is necessary to look at components in order to opine on the totality; perhaps additional emphasis on controls is warranted to address aggregation risk.

We agree with the possible actions proposed in paragraph 272b. With respect to “specific procedures,” we strongly support clarification of the distinction between an agreed-upon procedures engagement (AUP) under ISRS 4400, *Engagements to Perform Agreed-Upon Procedures Regarding Financial Information*, and reporting on specified procedures performed under ISA 600. The auditor is expected to exercise professional judgment; however, in an AUP engagement there is less focus on judgment and more on doing procedures as prescribed. We caution about the inclusion of performing AUPs in accordance with ISRS 4400, as the need to restrict the report may impede full communication. Clarifying the work effort related to analytical procedures would also be very helpful.

Regarding the possible actions in par. 279(c), we are concerned that the use of the word “challenging” implies the possibility of eliminating the option of a review. We do not support that; depending on the circumstances, a review may be appropriate. Taking it away would limit the auditor’s toolkit. We do support further exploration of how reviews can be used, perhaps with additional procedures. The objective is to obtain sufficient appropriate audit evidence; rather than restricting procedures, explain the extent and limitations of evidence provided by analytical procedures and inquiry.

Sub-consolidations is not an area that need as much focus. Subsequent events is often a concern, particularly in governmental entities in which the government does not have control over an independent entity that is required to be consolidated or included in the government’s financial statements, as described below in the response to GA13. Usually inquiry of group management and the component auditor provides sufficient appropriate audit evidence, but on occasion there are large time differences between the date audit work is completed at the component and at the group level. Implementation guidance in this regard would be helpful.

**GA8. *Review and Evaluation of the Work of Component Auditors by the Group Engagement Team***

***(a) Paragraphs 293–303 set out matters relating to the review and evaluation of the work of component auditors by the group engagement team.***

***(i) Which of the actions outlined in paragraphs 299 and 303 would be most meaningful in addressing issues relating to the review and evaluation of the work of component auditors by the group engagement team?***

***(ii) Why do you believe these actions are necessary?***

***(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

***(iv) Please also describe any potential consequences of those actions that you believe we need to consider further.***

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We support clarifying the standards to allow for consistent application by both practitioners and regulators and audit oversight bodies, who seem to have different interpretations of the extent of documentation required. Additional guidance of what is necessary to meet the requirements of ISA 230 in the context of a group audit would be helpful. As noted above, access issues and jurisdictional privacy laws can limit what the group auditor is permitted to include in the documentation.

Concerns have been raised by regulators that the documentation requirements in paragraphs 40 and 41 of ISA 600 are insufficient. We agree with strengthening the requirement to clarify the necessary work effort to review what the component auditor has provided. Just obtaining this information does not seem like sufficient action by the engagement partner. An inspector who looks at both the component audit and group audit would know more than the engagement partner, which is not optimal. We agree that the extent of the review required of the component auditor should not exceed that which would be undertaken in a non-group audit situation.

***GA10. Are there any other issues relating to group audits that we have not identified? If yes, please provide details. What actions should we take to address these issues?***

Other issues that have been identified include the following:

- Inconsistency in information requested regarding related party transactions. Some group auditors ask for a list of affiliates; some ask only about the specific entity.
- Consolidation, including how to show transactions that may or may not get eliminated on consolidation, and whether things are disclosed at the parent level; we refer to parent auditor.
- Inconsistency with how what the auditor does varies depending on the standard. For example, auditing investments accounted for at fair value at a fund of funds compared to auditing the same investment accounted for using the equity method at a different entity. Another example is when different requirements apply to component auditors, acting as the arms and legs of the group auditor, than would apply if the group auditor did the work themselves

***GA11. Are there any other specific actions that others could take in relation to group audits? If yes, please provide details.***

Actions that others could take include jurisdictions that permit access, and regulators, and audit oversight bodies agreeing on a common understanding of proper application of the standards. As noted above, engagement with IESBA on independence matters to address inconsistencies in current application of independence rules would be helpful.

***GA12. Are there any specific considerations for SMPs related to the issues and potential actions described in this section? Are there any other considerations for SMPs of which we should be aware? If so, please provide details and views about these matters.***

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Concern has been expressed that when dealing with international groups, SMPs are at a disadvantage in accessing the information necessary to be group auditor, and in providing access to information to the group auditor. There is a bias to use larger firms because it is easier to obtain the necessary understanding about them based on international networks. Due to the ability to make reference to component auditors in the U.S., SMPs may be used for parts of an audit domestically, but not when the audit involves foreign jurisdictions, due to the difficulty of getting information, such as peer reviews, understanding of jurisdictional quality controls, etc.

***GA13. Are there any specific public sector considerations related to the issues and potential actions described in this section? Are there any other public sector considerations of which we should be aware? If so, please provide details and views about these matters.***

See also GA1 for discussion of challenges based on accounting framework.

Governmental financial statements often include financial information of independent entities; for example, a non-governmental entity, such as a non-for-profit hospital or a state university, whose financial information is consolidated into the government's financial statements, or a fund whose financial information appears in its own column on the financial statements apart from the primary government (referred to as a discretely presented component unit [DPCU]). Because the component is an independent entity, the group auditor has no authority over and often no influence with the component auditor. This creates difficulties, some but not all of which are alleviated by the ability to make reference to another auditor. The area of subsequent events, as discussed above, is a particular concern in this regard. For example because, by definition, the DPCU's auditor must sign off on its opinion before the primary government's auditor signs off his or her opinion, this causes a time gap. Obtaining subsequent events updates from the DPCU is often difficult, as mentioned above, as there is really no requirement or incentive for the DPCU to cooperate. In addition, the financial reporting framework applicable to governments in the U.S. allow a DPCU to be presented on a different fiscal year-end than the primary government. For example, a primary government might have a December 31 fiscal year end and include a component unit with a September 30 fiscal year end.

Similarly, U.S. Generally Accepted Accounting Principles often requires consolidation of a not-for-profit entity when control and economic interest exists. Economic interest is created because the governing documents for exempt status require designation of another not-for-profit entity to take the assets if dissolution should occur. This often creates consolidation of entities where there is a board presence but not similar operations or even year ends. This creates audit execution challenges.

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May 16, 2016

Thank you for the opportunity to present our views on the ITC. If you have any questions regarding the comments in this letter, please contact Hiram Hasty at +1-212-596-6011, [hhasty@aicpa.org](mailto:hhasty@aicpa.org) or Ahava Goldman at +1-212-596-6056, [agoldman@aicpa.org](mailto:agoldman@aicpa.org).

Respectfully submitted,

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Chair, Auditing Standards Board