



Basel Committee on Banking Supervision

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

Via e-mail

Mr Thomas Seidenstein
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International Auditing and Assurance Standards Board
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2 October 2020

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

Dear Mr Seidenstein

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the IAASB's exposure draft on audits of group financial statements. The Committee has a strong interest in promoting high-quality auditing and ethical standards for auditors and is supportive of the work of the IAASB in setting such standards.

The Exposure Draft – Proposed ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* (ED-600) is important to the Committee. We expect the audits of most banks to fall within the scope of the standard, but it is particularly important for the audits of internationally active banks, those on which the Committee is most focused. Internationally active banks can have complex business models, organisational structures and arrangements (including centralised processing) as well as multiple intragroup transactions, and are subject to extensive laws and regulations that can materially affect their operations. Banks are also typically subject to accounting standards that require considerable judgment (eg in relation to the estimation of credit losses). These features may pose significant challenges to the effective audit of a banking group. A high-quality auditing standard is therefore essential to promote an effective and high-quality audit and, ultimately, enhance the effectiveness of prudential supervision on a consolidated basis.

In addition, Covid-19, whether or not a short-lived event, has shed light on the practical and operational difficulties that can arise when obtaining sufficient audit evidence from across a group, in particular on a global basis.

Against this backdrop, ISA 600 is a key standard that contributes to the high-quality audits of banks' group financial statements.

Overarching comment

The Committee welcomes the IAASB's decision to revise ISA 600. It agrees with the importance of the issues highlighted in ED-600 and is overall supportive of the

proposed approach. The Committee believes the enhancements made in ED-600 will contribute to higher-quality audits of banks' group financial statements.

The Annex to this letter provides detailed comments to the questions raised in ED-600. In our responses, we also make a number of recommendations that we believe would enhance the standard and related application material.

The following elements of ED-600 are particularly important to the Committee.

Risk-based approach

The Committee supports the development of the risk-based approach for the audits of group financial statements. Against the backdrop of the complexity and diversity of banking groups, we believe a risk-based approach of identifying and addressing the risks of material misstatements in the group financial statements is an effective way to foster audit quality for banking groups. We consider the risk-based approach a considerable improvement on the extant approach set out in ISA 600.

Responsibilities of the group engagement team and partner

The Committee agrees with the proposals in ED-600 to emphasise the responsibilities of the group engagement team and partner for the various elements of the audit (eg in paragraphs 4, 12, 31 and 52) – in particular, that the group engagement partner is responsible for managing quality at the engagement level and the group audit opinion.

The Committee considers it important that the special considerations applicable to the audit of group financial statements should not take away from the requirements to apply all relevant ISAs to the group audit. This is, in part, to ensure that the audits of different components of the group are undertaken in accordance with the same auditing and ethical standards, and that where a component is located in a jurisdiction where weaker standards apply, those weaker standards should not be used. The Committee believes that ED-600 could be clearer in this regard (see response to question 1 in the Annex).

The Committee also welcomes the fact that ED-600 clarifies the respective responsibilities of the group engagement team and the component auditors and the interaction between them, and the emphasis on the importance of the two-way communication between the group engagement team and the component auditor.

Quality management at the engagement level

The Committee supports the increased linkages to ISA 220 and the International Standard on Quality Management (ISQM) standards. We consider effective quality management of an audit engagement to be an essential element of an overall high-quality audit.

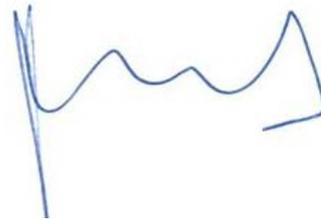
Other topics

The Committee is also supportive of ED-600 in other key areas, including scalability (question 5), restrictions of access (question 7), internal controls (question 9) and documentation (question 10).

We welcome the IAASB's commitment to support implementation of the standard (paragraphs 99 and 100 of the Explanatory Memorandum). Support will help enable proper and robust implementation of the standard. However, we would not wish to see requirements and application guidance removed from ED-600 as the standard is finalised and downgraded to the status of implementation material.

We hope you find our comments constructive and helpful. This letter has been prepared by the Committee's Accounting Experts Group, chaired by Fernando Vargas Bahamonde, Associate Director General of the Bank of Spain. If you have any questions regarding these comments, please contact Mr Vargas (+34 913 38 61 04), Michael Gaull, chair of the Committee's Audit Subgroup (+44 20 3461 5781), or Masaya Hatoma or Joanne Marsden at the Basel Committee Secretariat (+41 61 280 8577/8541).

Yours sincerely

A handwritten signature in blue ink, consisting of a vertical line on the left, followed by a series of connected loops and curves, ending in a short horizontal line on the right.

Pablo Hernández de Cos

Annex

Overall questions

1. ***With respect to the linkages to other standards:***

(a) ***Does ED-600 have appropriate linkages to other ISAs and with the proposed ISQMs?***

Yes.

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

The Committee acknowledges that audits of group financial statements are often complex and appreciates the IAASB's continued efforts to provide requirements and guidance that will enhance overall audit quality in audits of group financial statements. The Committee supports the text noting that ISAs apply to an audit of group financial statements and that ED-600 seeks to refer to, expand on and highlight how other relevant ISAs are to be applied in an audit of group financial statements. We would, however, prefer the first sentence of paragraph 1 in ED-600 to be more explicit (or for it be explained in the application material) that the auditor should apply the requirements and application material of all relevant ISAs when undertaking an audit of group financial statements and that this standard (ISA 600) does not repeat the requirements and application material in those ISAs.

The Committee believes that ED-600 largely addresses the special considerations in an audit of group financial statements. The following are areas in ED-600 where the Committee has recommendations:

Relevant ethical requirements (paragraph 20)

The Committee believes that the standard could be strengthened by inserting a new paragraph after 20(c), requiring the group engagement partner to obtain confirmation from the component auditors that they will promptly inform the group engagement team should they become aware of any breach of ethical requirements.

Differences in opinion (ISA 220 paragraph 37 - Draft from IAASB March 2020 meeting)

We believe group audits are particularly susceptible to differences of opinion, given their potentially complex nature and the involvement of component auditors. This applies also in the context of group audits of internationally active banks. ISA 220 paragraph 37 deals with how differences in opinion should be resolved. We believe that ISA 600 should include application material to clarify how to resolve differences in opinion when the component auditor is not from the same network firm as the group engagement team, since that paragraph is written assuming a single audit firm. We recommend that such guidance should include that the group engagement partner should communicate the relevant policies and procedures for dealing with and resolving differences between the component auditor and the group engagement team.

ISA 620 Using the work of an auditor's expert

Auditors often use specialists who are auditors' experts to assist the auditor in obtaining sufficient appropriate audit evidence. For certain sectors, including banking, extensive use of auditors' experts may be needed. The Committee believes that ED-600 should expand on the

requirements of ISA 620 regarding the group engagement team's responsibility in determining whether to use an expert, as well as the nature, timing and extent of the expert's work for the group and the components in the group. In particular, the Committee seeks clarity as to the group auditor's responsibility in respect of the component auditors' use of experts. For example, does the IAASB intend paragraph 23 to preclude component auditors from independently determining that they should be using experts, i.e. without the agreement or involvement of the group engagement team? If the component auditor can make use of experts independently, we believe ISA 600 should state that the group engagement team should be made aware and provide guidance to the component auditor on how to assess the experts' competence, capabilities and objectivity so that the group auditor is able to properly take overall responsibility for the work of the component auditors.

ISA 250 Considerations of laws and regulations in an audit of financial statements

The Committee believes that considerations of laws and regulations are crucial in a group audit, as entities or business units in a group might operate in different jurisdictions and industries which give rise to different local laws and regulations that could materially affect the group as a whole. Specifically, banks' activities are very highly regulated, subject to authorisations and ongoing supervision and it is fundamental that the group engagement team has a good understanding of laws and regulations. As such, we suggest that the application material in paragraph A56 related to relevant regulatory factors be elevated and moved to the main standard paragraph 24(a)(i)(d).

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

We agree that this is an appropriate structure for the reasons set out in Section 2-C of ED-600. We also think it reinforces the overall responsibility of the group engagement team for all aspects of the audit, as it emphasises that the involvement of the component auditor is a judgement made by the group engagement team when applying the foundational standards.

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

We agree that the discussion of professional scepticism in ED-600 in paragraphs 5, A9, and A10, as well the related references to professional scepticism in paragraph A238 of ISA 315 (Revised 2019) and paragraph A11 of ISA 540 (Revised), reinforce the exercise of professional scepticism in relation to an audit of group financial statements. Although the aforementioned discussion provides examples of how an auditor may document their use of professional scepticism, consideration should be given to expand how the use of professional scepticism can be documented in the auditor's work-papers. More specifically, we suggest that the documentation referred to in ED-600 paragraph 57(d) include a discussion of the procedures performed, the nature of the audit evidence, and basis for the auditor's conclusions. Documentation should include how evidence that contradicted management's assertions was considered.

Additional suggestions or matters of clarity:

- ED-600 paragraph A9: It would be useful to highlight that there is a risk of unconscious bias when using component auditors that may be part of the same network as the group engagement team. Notwithstanding that it is reasonable that some reliance be placed upon compliance with network wide policies and procedures, there is a risk the group engagement team is too accepting of the findings of the component auditor and fails to identify those occasions when it should step-back and apply greater scrutiny.

- ED-600 paragraph A9: it would also be useful to highlight the additional challenge that arises from the scale and complexity of many groups (eg complex legal structures, layers of management, different jurisdictions and languages, many and complex intra-group transactions). The complexity increases the susceptibility of the group financial statements to the risk of error and fraud, so it is important that the engagement team exercises scepticism throughout the audit process.
- Given the risks to the audit posed by the complexity of many groups, it would be appropriate for the group engagement team to frequently stand back and assess whether the progress of the audit is satisfactory (eg there has been the appropriate identification of risks, selection of audit procedures etc). Standing back at the risk assessment stage might be particularly important to ensure the auditor has identified the relevant risks and avoid undue pressure later in the audit if it is found that there are other risks to assess.
- ED-600 paragraph A9: the example in the application material is for the group engagement team to remain alert for contradictory information from component auditors. A further example that focuses on the component auditors themselves may help reinforce the application of paragraph 5 to the component auditor as part of the engagement team. For example, the group engagement team could ask the component auditor to communicate potentially contradictory information (eg matters communicated by the group engagement team or other component auditors contradicts the assertions of component management) they become aware of (including information they become aware of after they have formally reported to group engagement team).

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

We believe the scope of application of ED-600 is clear, and we agree with paragraph 24 of the explanatory memorandum (EM) that ED-600 should apply to all audits of group financial statements regardless of whether component auditors are involved.

We note the IAASB does not propose defining entities or business units. Given the range of organisational forms we agree it could be a challenge to provide a clear and comprehensive definition, in particular as it is not the intent of the standard to completely align with the definition of a group under any particular accounting framework (eg ED-600 includes item (b) in paragraph 11; aggregated financial statements are not 'group' financial statements under many accounting frameworks).

Paragraph 2 of the extant ISA 600 has been deleted for the reasons set out in paragraph 28 of the EM. We think the retention of this paragraph may still be useful to deal with other scenarios that are not obviously covered by other ISAs, and where many of the principles and requirements of this standard would be relevant consideration, for example the audit of:

- a subsidiary entity within a group, in particular where the group has a high degree of centralisation. The subsidiary auditor should understand the impact of other group entities on the subsidiary audit, procedures may be allocated to the group engagement team, and there should be effective two-way communication. In practice, we have seen references to group engagement teams as component auditors in this scenario.

- an entity with a number of overseas branches having the ability to account centrally for those branches. Under ED-600 paragraph A17 this scenario would be outside the scope of the standard, yet auditors local to the branches may be needed. With increased IT processing ability, the production of centralised information without the need for an intermediate step to produce a branch return may increase, and so this scenario may become more prevalent.

Additional suggestions or matters of clarity:

- ED-600 paragraph A6: in relation to a subgroup, we think it would be useful to clarify that the centralised or shared services may be provided by an entity that is part of that subgroup's wider group but is not part of the subgroup (eg by a parent of the subgroup), and that in this case that shared service centre may also be a component.
- ED-600 paragraph 2: we do not think it is necessary to refer to a consolidation process as "a key factor". The definition of group financial statements in paragraph 9(k) indicates that a consolidation process is the only factor.
- ED-600 paragraph 11: we are not sure that 'includes' is required within the first line. References to the consolidation process 'is' ... (a) ..., (b)... and (c)....

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

The Committee believes ED-600 is relatively scalable and flexible to groups of different sizes and especially for smaller, less complex groups comprised of only a small number of entities or business units.

In particular, we believe the following factors improve the scalability of the standard:

- On the principle, the introduction of the risk-based approach and the group engagement team's focus on identifying, assessing and responding to the risks of material misstatement of the group financial statements requires the design of procedures adaptable to a wide variety of groups of different complexity. It highlights the responsibility of the group engagement team in the definition of the audit approach and its conduct.
- By emphasising the importance of professional scepticism, especially when the group engagement team determines the direction of the work of the component auditors, ED-600 highlights the responsibility of the group engagement team in the scope of the component auditor's involvement.
- By editorial form, the placement of sub-sections throughout ED-600 that highlight the requirements when component auditors are involved, provides scalability for circumstances where the group engagement team does not involve component auditors by making it easier to identify which requirements apply and which do not.

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

We support the revised definition of a component to focus on the 'auditor view'.

The usage of the term 'component' is in the context of conducting the audit. In this regard it seems appropriate that it should be the auditor's view as it is the auditor who is responsible for

the conduct of the audit. If the term is linked to management's view, there may be a risk that it unduly restricts the auditor in the risk assessment and development of appropriate procedures.

Expressing the term as the auditor's view does not prevent the auditor from having the same view as management. It does, however, allow the auditor to deviate where considered appropriate to do so.

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

The Committee acknowledges the importance of access to people and information at the components of a group and that ED-600 cannot enforce access to people and information, but that it can help by developing guidance for situations where access to people or information is restricted. Access to people and information has a significant impact on the ability of the group engagement team to conduct the audit activities effectively.

The Committee appreciates the different approaches envisaged by ED-600 for restrictions on access outside the control of group management and for restrictions on access imposed by group management. In particular, we are supportive of ED-600 not alleviating the requirement for the group engagement team to obtain sufficient appropriate audit evidence and including application material to overcome restrictions on access to information or people and deal with this situation.

Additional drafting suggestions or matters of clarity:

- ED-600 paragraph 13: an understanding of the relevant laws and regulations in operation in different jurisdictions is essential to understanding whether there are likely to be restrictions on information access. We recommend that paragraph 13 specifies that, as a minimum, the group engagement team should obtain an understanding of the relevant laws and regulations applying to the group that may impose restrictions on the ability of group engagement team to receive information.
- ED-600 paragraph A21: the application material could be usefully expanded to suggest that the group engagement partner should seek an understanding of the level of ownership and control over entities within the reporting entity. This may not align with the legal structure in all circumstances, yet can be relevant to determining the entities included in the consolidation. It may also help identify potential restrictions on access by highlighting areas where an investor within the audited entity lacks control.
- ED-600 paragraph A22: the illustrative sources of information are almost all internal to the audited entity. It would be beneficial for the auditor to also consider whether there are more third party sources that could provide relevant information (eg a network firm may be able to provide information on the economic, business, regulatory and political environment in relation to a component).
- ED-600 paragraph A35: a cross reference to paragraphs 13 and 14 and the related application material may clarify what the group engagement team should do if the restrictions are such that sufficient appropriate evidence cannot be gathered.
- ED-600 paragraph A35: the group engagement team could also request that the component auditor should inform the group engagement team at the earliest opportunity of any matters that may mean the component auditor is not able to conduct the work as directed by the group engagement team or that otherwise might impose restrictions on information sharing.

8. Will the risk-based approach result in an appropriate assessment of the risks of material misstatement of the group financial statements and the design and performance of appropriate responses to those assessed risks?

The Committee strongly supports the development of the risk-based approach for the audits of group financial statements. Against the backdrop of the complexity and diverse activities of many banking groups, we believe the risk-based approach of identifying risks of material misstatements and minimising them through focusing the audit resources is an effective way to foster quality for the audit of banking groups.

In particular, the IAASB is interested in views about:

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

The Committee believes that the respective responsibilities of the group engagement team and the component auditors and the interaction between them are clear in ED-600. In particular:

- ED-600 clarifies the interactions that are needed between the group engagement team and the component auditors under the risk-based approach throughout the different phases of the audits of group financial statements and makes it clear that when component auditors are involved, they are an integral part of the engagement team.
- ED-600 states that the group engagement team has overall responsibility. Component auditors may be involved and when component auditors are involved, the group engagement team needs to direct, supervise and review their work.

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

The Committee supports the enhanced application material relating to the two-way communication between the group engagement team and the component auditor. In addition, the Committee agrees with the new requirement (paragraph 44(e)) that component auditors should report the description of any identified deficiencies at the component (the extant ISA 600 requires significant deficiencies only to be reported).

Additional drafting suggestions or matters of clarity:

- ED-600 paragraphs 32 and A82 to A84: it would be useful to clarify in the application material that where the group engagement team determines that the component auditor's work is not an appropriate basis, the group engagement team undertakes further work to make the assessment.
- It would be helpful to clarify in the application material that when the component auditors are from an audit firm that is not part of the group engagement team network, the component auditor may not be familiar with the policies and procedures of the group engagement team. The group engagement team may therefore need to give particular attention to communicating the audit strategy (and transmit information and audit instructions) to respond to assessed risks, to ensure the component auditor understands what is expected of them.
- ED-600 paragraph A106: to support effective two-way communication, we would recommend adding to application material that the group audit strategy also be

communicated. This would further help set the expectations for the component auditor by enabling them to understand where they fit within the overall audit.

- ED-600 paragraph A112: it may be helpful to add new application material to clarify that a component auditor that is also appointed as the statutory auditor for a component, should also consider whether any Key Audit Matters raised as part of the statutory audit should be reported to the group engagement team. This could perhaps be given as a specific example of 'any other matters' described in paragraph 44(g).

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

The EM (eg paragraph 54) and ED-600 set out many of the features of groups that give rise to practical challenges (including the complexity of group structures and operations, the range of geographical locations with potentially different laws and regulations, and languages and cultures).

Our thoughts on the practical challenges are:

- The complexity of many groups (and as groups grow in scale, complexity typically increases) can make it hard to gain a comprehensive understanding of a group. This can make it difficult to identify all risks, but also to assess the magnitude of risks. For example, risks may be spread across the group in a way that hides their combined effect (eg different parts of a banking group may lend to the same counterparty or group of related counterparties, different parts of a banking group may hold equity and bonds in an entity as well as providing loan facilities), or risks may be transferred between group entities (eg it is common for banking groups to transact business in one jurisdiction but book that business to a legal entity in a different jurisdiction, or there is centralised risk management for business transacted across the group).
- The diversity of groups, in particular across jurisdictions with their own legal and regulatory systems, and subject to local market and economic conditions, result in it being unlikely that the group engagement team will be able to fully understand all environmental risks in a group. This is particularly the case for certain sectors (eg banking) that are subject to extensive and detailed regulations. The group engagement team may need to make use of the expertise and local knowledge of component auditors to understand and assess the risks. This also means that the group engagement team may face a challenge when assessing the adequacy of the component auditor's work.
- Where a risk of material misstatement is spread across a number of jurisdictions, no one component auditor may be suited to undertake all the procedures. This very much puts the onus on the group engagement team to identify, assess and determine the procedures that need to be undertaken, and to project manage the work, collate and evaluate the results.
- Under the extant ISA 600, a component may be more closely related to a local set of financial statements upon which the component auditor gives a view. Under ED-600 this link may be broken or become more distant. As a result, the component auditor's work may lose some benefits derived from the audit work on the local financial statements – eg quality control procedures undertaken to meet the local audit requirements, which the component auditor may not implement if instructed under the new risk-based approach. We would note, however, that these are additional benefits, as the audit work on the component should nevertheless be undertaken in accordance with the relevant auditing and ethical standards applicable to the group.

The implications generally are that a risk-based approach to audits of group financial statements will be challenging or more difficult, as indicated in ED-600 paragraphs A78 and

A87. We do not believe, however, that the challenges mean that a risk-based approach should not be applied. In this regard, linking ED-600 with ISA 220 is important to emphasise the group engagement team's obligations to manage the audit effectively (eg to ensure sufficient resources with the appropriate skills and competence are made available to deal with the practical challenges in undertaking a risk-based approach to the audit of group financial statements).

We also believe that ED-600 is an improvement over the extant ISA 600. ED-600 seems better suited to deal with the issues because of the changes made to deliver the objectives and approach set out in paragraphs 48 and 50 of the EM. While there might be broader coverage of the financial statements using the extant ISA 600's definition of components¹, this is not necessarily a risk sensitive approach and so may not identify and address adequately the risks of misstatement and result in an effective evaluation of those risks. For example:

- A component is defined by reference to how management prepares financial information, which may act as an impediment to thinking about how risks sit across the group from an audit perspective, and to developing procedures to respond to those risks (see also response to Question 6)
- While the auditor is required to assess the risks of material misstatement of the group financial statements (paragraph 18(b) of the extant ISA 600), there is a risk that paragraph 27 of the extant ISA 600 is interpreted that risks can only arise in a single component, or there is a risk the focus is on the component where the majority of the risks resides. As a result there may be insufficient consideration of the total risk.
- Paragraph 27 of the extant ISA 600 allows an 'audit' of the financial information of the component to be undertaken for the purpose of responding to the assessed risks at the group level. There may be a tendency to default to this option as noted in paragraph 48 of the EM, because, for example, it aligns with local management's needs. This may lead to insufficient attention being given to the risks of material misstatement to the group financial statements, as attention is diverted to matters that are not a significant risk in a group context.

Additional drafting suggestions or matters of clarity

- There may also be additional measures the group engagement team can take to minimise the risks that the audit is not performed effectively, for example, to require enhanced independent quality control procedures be performed by the component auditor. It is not clear that this is captured within ED-600 paragraph 21 and the related application material.

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

We support the additional material on the commonality of controls and centralized activities and believe that it is appropriate. However, we suggest that ED-600 (Requirements, Application Material and Appendix 3) be enhanced as follows:

- Expand Appendix 3 to include a statement that the group engagement team's understanding of the system of internal control over financial reporting (ICFR) may include consideration of the extent to which controls across the group are consistent

¹ ISA600 paragraph 9(a)

and fully integrated at the group and component level and the implications for the planned audit approach.

- Add to the application material enhanced linkages to the requirements in ISAs 315 and 330 regarding responsibility for evaluating whether controls have been designed effectively and have been implemented, and where relevant, ensuring that the operating effectiveness has been tested, in particular where those controls are not common across the group.
- Expand Appendix 3 to include examples of control deficiencies that would be indicators of significant deficiencies at both the group and component levels. Such examples of indicators of significant deficiencies could include the following: identification of fraud, whether or not significant, on the part of senior management; restatement of previously issued financial statements to reflect the correction of a material misstatement due to fraud or error; identification by the auditor of a material misstatement of the financial statements under audit in circumstances that indicate that the misstatement would not have been detected and corrected by the entity's ICFR; and ineffective oversight of the entity's financial reporting and ICFR by those charged with governance.
- Expand Appendix 3 to discuss the effects of an ineffective ICFR system on the audits of group financial statements.
- ED-600 paragraphs A59 and A60: expand upon the reason for identifying common controls and the relevance to the audit of group financial statements, as paragraph A65 does for centralised activities. We note there is some discussion of the relevance in paragraph A63, but this is in the context on the level at which controls are performed, rather than more generally.
- ED-600 paragraph A60: clarify the interaction of the group engagement team and component auditor. While we understand and agree that the group engagement team should remain responsible for the audit approach and the judgements made, we understand that the component auditor may be used to assist in the evaluation. It is not clear from A60 that this is envisaged.

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

The Committee supports ED-600's emphasis on component performance materiality under the risk-based approach. In ED-600, the group engagement team determines the component materiality to be used in the planning and performing on the disaggregated financial information of the components. In this regard, a definition of aggregation risk has been included and it has been clarified that the component materiality is determined by the group engagement team to reduce the aggregation risk.

The Committee welcomes the application material on aggregation risk. We appreciate the list of factors that the group engagement team may take into account when defining component materiality. In this regard, we would recommend that regarding:

- ED-600 paragraph A75: the group engagement team could also take into account the implications of different currencies in use across the group and how they may affect the aggregation or disaggregation of materiality – in particular where rates are volatile.
- ED-600 paragraph 29(a): adding new application material that the group engagement team may also find it helpful to understand and consider the implications of any materiality (both qualitative / quantitative) applied by a "local" auditor when auditing a

subsidiary, regardless of whether that subsidiary audit represents a component (it could be that local materiality highlights issues that may be relevant to consider at the level of the group audit).

- ED-600 paragraph A77: the group engagement team may also consider any regulatory requirements at the component level (both qualitative and quantitative) that can have an impact in defining the thresholds above which misstatements identified in component financial information are clearly trivial to the group financial statements.

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

- (a) **Are there specific matters that you believe should be documented other than those described in paragraph 57 of ED-600?**
- (b) **Do you agree with the application material in paragraphs A129 and A130 of ED-600 relating to the group engagement team's audit documentation when access to component auditor documentation is restricted?**

The Committee is supportive of the enhanced documentation requirements, including the linkage to ISA 230² in ED-600.

The Committee believes that discussions of significant matters with management, those charged with governance, and others such as regulatory authorities, including the nature of the significant matters discussed and when and with whom the discussions took place should be included in the items in ED-600 paragraph 57 to be documented, in line with ISA 230 paragraph 10. The significant matters discussed at both the group and component level with management and those charged with governance should be documented as they can form part of the group engagement team's understanding of the entity and its environment, risk assessment and/or audit evidence to support conclusions reached.

We agree with the application material in paragraph A129 and A130 and appreciate the IAASB's efforts to address the challenges that could arise in an audit of group financial statements when restrictions to access of the components' documentation arise. We commend the IAASB for emphasising that the group engagement team is still required to obtain sufficient appropriate audit evidence regardless of such restrictions.

Additional drafting suggestions or matters of clarity:

- ED-600 paragraphs A124 to A130: We recommend that the paragraphs also include considerations when there are restrictions to the component auditor's documentation when the component auditor is from a different firm or network than that of the group engagement auditor.

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

We have the following additional suggestion to enhance the standard:

- ED-600.41: the requirements could be strengthened by adding a new paragraph 41(c) to require that the component auditor report any breaches in laws and regulations of which they become aware.

² Audit Documentation

We have the following additional drafting suggestions or matters of clarity to the Application material:

- ED-600 paragraphs 32 & A82 to A84: the application material could recognise explicitly that the group engagement team may need to involve a number of component auditors in assessing the significance of a single risk, and the group engagement team may therefore need to coordinate the risk assessment.
- ED-600 paragraph A56: the application material within the bullet points could usefully also highlight that the auditor should gain an understanding of the location of significant service centres within the group, as these may be a key area of audit focus.
- ED-600 paragraph A56: the application material could usefully highlight the need to understand a group's booking arrangements and approaches to risk management as they add complexity to the group and therefore increase the financial statements' susceptibility to material misstatements. For example, within a banking group transactions may be entered into in one jurisdiction but booked to the balance sheet of an entity in a different jurisdiction. The group engagement team may therefore need to use different component auditors in respect of different parts of the transaction. The group engagement team will need to assess the risk and communicate it to the component auditors. Alternatively, a banking group may book transactions locally and carry out treasury or hedging activities within a single group entity. This may result in intra-group transactions that will need to be adjusted for appropriately upon consolidation.
- ED-600 paragraph A72: the application material could helpfully identify that certain sectors (eg banking) may be particularly susceptible to the risks highlighted.
- ED-600 paragraphs A103 to 105: the application material could promote further professional scepticism by providing guidance that, even if there is no intention to use such work, the group engagement team should consider whether there is any contradictory information that might prompt the group engagement team to undertake further procedures.

Request for General Comments

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

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

No comment.

(b) Effective Date—Recognizing that ED-600 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.

We would welcome the earliest possible adoption.