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October 2, 2020

Mr. Willie Botha

Technical Director

International Auditing and Assurance Standards Board

529 Fifth Avenue

New York, New York 10017

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

Dear Mr. Willie Botha:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, DC, the CAQ is affiliated with the American Institute of CPAs. This letter represents the observations of the CAQ but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ appreciates the opportunity to share our views and provide input on the proposals included in the International Auditing and Assurance Standards Board's (IAASB or the Board) Exposure Draft, International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (the Exposure Draft, the proposed standard or ED-600). The CAQ is supportive of the IAASB's efforts to strengthen the auditor's approach to planning and performing a group audit and to clarify the interaction between group audit requirements and the requirements of other ISAs through the use of a principles-based and risk-based approach. Overall, we believe that a principles and risk-based proposed standard is an improvement over extant ISA 600. We recognize that the Board has been working to revise extant ISA 600 since the project was approved by the Board in December of 2016 and appreciate its outreach to date with other IAASB task forces and key stakeholders. We encourage the IAASB to continue to collaborate with



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other standards setters, including the Public Company Accounting Oversight Board (PCAOB), which also is in the process of updating its standard to strengthen requirements related to the use of other auditors, as auditors may need to apply ISA 600 as well as local standards in conducting a multilocation or group audit.

Overall, we support the focus on sufficient and appropriate involvement of the group engagement team in planning and performing the group audit. We also support the Board's recognition in the proposed standard of the important role that the component auditor continues to play in group audits and the acknowledgement that the group engagement partner is permitted to assign certain procedures, tasks or actions to other appropriately skilled or suitably experienced engagement team members. However, we are concerned that it may not be possible for respondents to the IAASB's request for comment to fully assess the proposed requirements in ED-600 without proposed ISA 220 (Revised), *Quality Control for an Audit of Financial Statements* being finalized. As noted in our July 2019 response to the IAASB's quality management exposure drafts, given the potential impact that the principles in proposed ISA 220 have on those that govern a group audit, we recommend that the Board align the requirements in proposed ISA 220 and ED-600 where appropriate to achieve its intended objectives. As it relates to proposed ISA 220, we are concerned that the practical implications of the proposed revised responsibilities of the engagement partner when applied to group audits conducted in accordance with ED-600 have not been sufficiently evaluated. Given the timing of when the Board expects to finalize proposed ISA 220, we believe amendments to a finalized ISA 220, or other transition guidance, is needed to address the interaction between ISA 220 and ED-600 prior to these standards becoming effective.

As it relates to ED-600, the following observations are for the Board's consideration:

1. *Proposed definition of group financial statements - We recommend the Board consider removing paragraph A17 from the related application and other explanatory material.*

We generally support the Board's intent with the proposed definition of group financial statements included in paragraph 9(k) of ED-600 and the Board's intent to clarify the scope of ED-600 to include how the definition should be applied to shared service centers, entities with branches and divisions and non-controlled entities, including equity-accounted investees and investments carried at cost. While paragraph 11 of ED-600 uses the phrase "consolidation process," we believe the Board should consider the difference in how the proposed standard uses this phrase, as compared to how the term "consolidation" is generally applied in financial reporting frameworks.

We recommend that the Board consider removing paragraph A17 of the application and other explanatory material included within ED-600. Specifically, in the context of paragraph 11 of ED-600, the Board's intent is not clear as it relates to the following statement from paragraph A17 of the application and other explanatory material: "*In*



some circumstances, the accounting for the branches or divisions may be performed centrally, and there is no separately prepared financial information for the branches or divisions that requires aggregation.” We believe that the aforementioned proposed language could be confusing to auditors and potentially result in diversity in practice as to when branches or divisions of an entity are intended to be within the scope of ED-600 and when they are not.

- 2. Proposed definition of component – We suggest the Board provide additional clarification around the application of ED-600 in scenarios where the auditor’s definition of a component differs from how the entity’s management has structured or otherwise views the business.*

We generally support the Board’s intent in revising the standard to provide the auditor flexibility to consider the many ways in which the group structure might be viewed in designing the most effective and efficient approach to planning and performing a group audit.

However, this is a significant change from existing practice and auditors may not fully understand the IAASB’s intent in moving from a “management view of the business”, which historically has been closely linked to discrete financial information, to an auditor view when scoping a group audit. Accordingly, we suggest that the Board consider providing additional clarification as to the application of ED-600 in scenarios where the auditor’s definition of a component differs from how the entity’s management has structured or otherwise views the business. For example, paragraph A15 in the application and other explanatory material provides clarification of the definition of component management in the proposed standard; however, it is not clear how this definition should be applied in situations where the auditor combines multiple business units that have different management.

- 3. Determining components and scoping a group audit – We suggest the Board consider enhancing the proposed requirements to provide greater clarity as to how the auditor determines components and sets out an appropriate approach to a group audit that enables the auditor to obtain sufficient appropriate audit evidence.*

The Board highlights its view of how the risk-based approach to a group audit can be characterized in paragraph 50 of the explanatory memorandum. Such discussion includes the judgments about how, by whom and where audit procedures will be performed to obtain audit evidence based on the group engagement team’s view of the group structure. It would be helpful to explain the interaction among paragraphs 31, 33 and 49 and to provide additional guidance to give further emphasis to scoping a group



audit. We would suggest the guidance include explanations of how the group engagement team establishes an overall group audit strategy in accordance with ISA 300, *Planning an audit of financial statements*, which includes the identification of components and consideration of whether to involve component auditors. Further emphasis could be given to how, based on the auditor's identification of significant classes of transactions and account balances, the auditor determines the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient appropriate audit evidence to obtain reasonable assurance about whether the group financial statements are free of material misstatement. The factors set out in paragraph 12 of the PCAOB's Auditing Standard 2101, *Audit Planning*, could help provide a framework for auditors in determining where audit procedures should be performed. This also could lead to more consistency in judgments in relation to aggregation risk.

4. *Proposed addition of sufficient time determination - We suggest the Board provide additional clarification around the proposed requirement in paragraph 21(a) of ED-600 that the group engagement partner shall determine that the component team has "sufficient time to perform the assigned audit procedures at the component."*

We support the Board's intent to ensure the component auditor has sufficient time to perform the work to which they are assigned as we believe this is important when executing a high-quality group audit. It is not clear in ED-600 what the group engagement partner is being required to perform, incremental to what is being proposed in, Exposure Draft, Proposed International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements* (ED-ISQM 1), to determine that the component auditor has sufficient time to perform the assigned audit procedures at the component.

We acknowledge the sufficient time requirement in ED-600 is based on the requirement in proposed ISA 220, but we believe it could cause practical challenges in a group audit. In most cases, we believe the group engagement team will be relying on communication from the component engagement partner as a basis for making such a determination, but it is unclear whether additional efforts would be expected, including the nature of any related documentation.

In addition, ED-ISQM 1 already includes a proposed requirement in paragraph 38(b) which states that "The firm assigns an engagement partner and other human resources to each engagement who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements." This requirement would be applicable to the component auditor as part of the component auditor's system



of quality management. We believe clarification on this topic would be helpful to practitioners if the requirement is not removed from ED-600.

5. *Engagement Resources – Competence and capability of the component auditors and component auditor monitoring and remediation process or external inspections - We recommend the Board consider amending the related application and other explanatory material in paragraph A42 and moving the proposed requirement in paragraph 21(b) of ED-600 from the proposed standard to the application and other explanatory material.*

We support the Board’s decision to substantially retain the requirement for the group auditor to determine the component auditor’s competence and capabilities as we believe this is a critical step in planning and performing high-quality group audits. We also believe that the examples of the types of procedures that an auditor may perform to determine the component auditor’s competence and capabilities included in paragraph A43 of the application and other explanatory material help illustrate the Board’s intent with respect to this requirement. We recommend, however, that the Board consider revising the first sentence in paragraph A42 of the application and other explanatory material to read as follows: “The group engagement partner’s determination as to ~~in~~ determining whether component auditors have the appropriate competence and capabilities to perform the necessary procedures at the component for purposes of the group audit, the group engagement partner may consider matters such as involves consideration of one or more of the following matters:”

In addition, we recommend that the following proposed requirement included in ED-600 paragraph 21(b) be relocated into the application and other explanatory material: *“When information has been provided about the results of the monitoring and remediation process or external inspections with respect to the component auditor’s firm, determine the relevance of such information to the group audit and determine its effect on the group audit.”* We believe that it is currently unclear as to what is being required of the auditor in addition to the requirements outlined in paragraph 21(a) of ED-600. Specifically, the phrase *“When information has been provided”* could create confusion as to how much effort the auditor is expected to expend searching for such information in order to satisfy this proposed requirement. We believe the requirement was intentionally phrased to acknowledge that information about the component auditor’s firm may not always be accessible by the group auditor (for example, due to local jurisdiction privacy and confidentiality laws and regulations).

6. *Engagement Resources - We suggest the Board consider revising paragraph 22 of the proposed standard to remove the reference to paragraph 21.*



As it relates to paragraph 22 of the proposed standard, we support the objective for the group engagement partner to obtain sufficient appropriate audit evidence related to the work to be performed at the component.

We suggest, however, that the Board consider revising the first sentence of paragraph 22 of the proposed standard to read as follows: “If the group engagement partner has serious concerns about any of the matters in paragraphs 18– 210, including if a component auditor does not meet the independence requirements that are relevant to the group audit, the group engagement team shall obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving that component auditor.” We believe that the proposed standard as drafted could be misunderstood such that if serious concerns are raised related to the component auditor’s competence and capabilities, the group engagement partner would be unable to involve the component auditor, even if additional safeguards are put in place to mitigate such concerns. Certain of the concerns that could be identified related to paragraph 21 of the proposed standard can be overcome through incremental steps or actions performed by the group engagement team in order to mitigate such concerns.

For example, if the group engagement partner of the audit of a bank determined that the component auditor did not have sufficient banking industry experience, the group engagement partner may decide to supplement the component audit team with a group engagement team member to address this concern. It is unclear from the proposed standard as written whether such concerns represent a “serious concern” as described in paragraph 22 and whether it can be mitigated such that the group engagement team would be able to continue to use the component auditor to support the group audit.

7. *Aggregation Risk- We suggest the Board consider providing examples of how aggregation risk would be applied to different scenarios in the form of implementation guidance.*

We support the Board’s intent in ED-600 to clarify how the concepts of materiality and aggregation risk apply in a group audit. We also support the Board’s inclusion of a definition of aggregation risk in paragraph 9(a) of ED-600.

We suggest that the Board consider providing examples of how the Board intends for aggregation risk to be applied to different scenarios through implementation guidance. We believe that such guidance would be helpful to practitioners and would limit diversity in practice.



We appreciate the opportunity to comment on the Exposure Draft. As the IAASB gathers feedback from other interested parties, we would be pleased to discuss our comments or answer any questions regarding the views expressed in this letter. Please address questions to Vanessa Teitelbaum (vteitelbaum@thecaq.org) or Catherine Ide (cide@thecaq.org).

Sincerely,

A handwritten signature in black ink that reads 'Catherine Ide'.

Catherine Ide
Vice President, Professional Practice
Center for Audit Quality

cc:

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