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September 9, 2020

Mr. Willie Botha
Technical Director
International Auditing and Assurance Standards Board
International Federation of Accountants
529 5th Avenue, 6th Floor
New York, NY 10017, USA

Dear Mr. Botha,

Re: JICPA Response to the Proposed International Standard on Auditing 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*

The Japanese Institute of Certified Public Accountants (JICPA) is grateful for the opportunity to comment on the proposed ISA 600 (Revised), *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* (ED-600).

Major points

Our major points are as follows:

Clarifying the component auditor's responsibilities

We agree that it is appropriate, by itself, to reinforce the group engagement team's responsibility through the risk-based approach for the risk assessment procedures and further audit procedures over the financial information of the component. However, there are several descriptions which, by overemphasizing it, could cause the misunderstanding that the component auditor's responsibilities under ED-600 would be lighter than those under the extant ISA 600.

We should clarify that the component auditor is responsible for exercising professional skepticism and obtaining sufficient appropriate audit evidence as directed and supervised by the group engagement team. We believe that it is essential for the component auditor to take this responsibility in order to achieve a high-quality group audit (see our comments to Questions 3 and 8(a)).

Embedding the concept of significant components

We agree that the group engagement team shall obtain an understanding of the group and its environment to lead

risk assessment procedures on the group financial statements. On the other hand, we believe that it is very difficult in practice for the group engagement team on its own to undertake risk assessment procedures on the group financial statements in a complete manner. For a high-quality group audit, it is essential that component auditors who have a deeper knowledge of the components be involved in the group audit, and that both the group engagement team and the component auditors perform risk assessment procedures on the group financial statements in a practically necessary and sufficient manner from each perspective.

However, while ED-600 emphasizes the group engagement team's responsibility for designing further audit procedures in response to the assessed risks and its involvement in the work performed by the component auditor through the risk-based approach, there is insufficient guidance on what responses the group engagement team should take. As a result, there are concerns that a high-quality group audit might be impeded.

Therefore, we propose that the concept of significant components be retained in conjunction with the risk-based approach. By retaining the current concept (i.e., performing work on identified significant components and selecting additional components other than significant components on which to perform certain work) in the risk-based approach, we believe that it can prevent the unintended consequence of endless expansion of the scope of audit procedures. We also believe it ensures that the group engagement team invests adequate audit resources in the necessary areas (see our comments to Question 8(c)).

The attached are our comments on matters that we consider to be addressed, including some of the questions in "Request for Comments." We hope that our views will be of assistance to the IAASB.

Sincerely yours,

Sayaka Shimura
Executive Board Member - Auditing Standards
The Japanese Institute of Certified Public Accountants

Comments on “Request for Comments”

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?**
- (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?**

(Comments)

We believe that ED-600 has appropriate linkages to other ISAs and the proposed ISQMs. We also consider that ED-600 sufficiently addresses the special considerations in a group audit.

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?

(Comments)

We support the placement of sub-sections.

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

(Comments)

We do not believe that the requirements and application material of ED-600 appropriately reinforce the exercise of professional skepticism in relation to an audit of group financial statements.

There are several descriptions which could cause the misunderstanding that the component auditor has only to follow the instructions of the group engagement team without further consideration.

For example, paragraph A100 states that “the component auditor may need to consider the sufficiency and appropriateness of audit evidence obtained in performing the further audit procedures with respect to the financial information of the component.” However, it should correspond to a requirement for the component auditor’s responsibility. It is primarily the component auditor’s responsibility to consider the sufficiency and appropriateness of audit evidence obtained, while the consideration is performed based on the group engagement team’s direction,

supervision and review, as well as based on two-way communication between the group engagement team and the component auditor. We believe that using the word “may” in this application material does not appropriately reinforce the exercise of professional skepticism in a group audit.

In paragraph A80, there are illustrations of information used to identify the risks of material misstatement of the group financial statements due to fraud, but most of them are related to the entire group, not to individual components. In actual audit practices, however, in many cases the component auditor can identify indications of fraud that may be difficult for the group engagement team to identify at the group level, and the appropriate involvement of the component auditor results in detecting a material misstatement of the group financial statements due to fraud as a result of performing audit procedures for those indications. In this regard, ED-600 does not appropriately emphasize the importance of the component auditor’s responsibility, as a result of the excessive emphasis on the group engagement team’s responsibility. We therefore believe that ED-600 does not appropriately reinforce the exercise of professional skepticism in relation to a group audit.

See our comments on Question 8(a) below for our suggestions on clarifying the component auditor’s responsibility.

Specific Questions

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

(Comments)

We believe the scope and applicability of ED-600 is clear. We support the definition of group financial statements.

- 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?**

(Comments)

We believe the proposed standard is scalable.

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?

(Comments)

We believe that the definition of “component” in the extant ISA 600 is not clear enough to determine whether an entity or business activity such as a shared service center falls under a component, and we understand ED-600 intends to clarify it. However, we believe the following points should be clarified.

Definition of “Component Management” (Paragraphs 9(d) and A15)

For example, in the case of a shared service center, the management who is responsible for the financial information preparation processes may differ from the management who is responsible for the business underlying the financial information. In such cases, it should be clarified what “component management” refers to, or both.

Branches in the Consolidated Process (Paragraph A17)

Based on the description in paragraph A17, if a branch prepares separate financial information to be aggregated into the financial statements, these financial statements fall under group financial statements in the light of the definition in paragraph 9(k). Nevertheless, we think that most companies prepare a certain kind of financial information for each branch (e.g., in a case where branches are treated as profit centers, they would prepare an income statement or equivalent financial information). Therefore, individual financial statement audits would also be defined as a group audit in most cases, but it should be clarified whether this is consistent with the intent of ED-600.

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?

(Comments)

We support the enhancements to the requirements and application material.

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

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

clear and appropriate?

(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?

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

(Comments on 8(a))

We believe that reinforcing the group engagement team's responsibilities, in itself, is appropriate, but there are several descriptions which, by overemphasizing it, could cause the misunderstanding that the component auditor's responsibilities under ED-600 would be lighter than those under the extant ISA 600.

For example, paragraph A100 states that "the component auditor may need to consider the sufficiency and appropriateness of audit evidence obtained in performing the further audit procedures with respect to the financial information of the component." However, we believe that this consideration should be the component auditor's responsibility, and using the word "may" sounds as if the component auditor's responsibility would be lightened.

To clarify the component auditor's responsibilities, we suggest that a requirement or application material be established for, for example, the following points.

- The component auditors shall perform their work in accordance with the direction and supervision of the group engagement team, in compliance with appropriate auditing standards such as ISAs.
- In the course of the component auditor's work, when the component auditor identifies an indication of fraud or possible material misstatement, the component auditor is responsible for obtaining sufficient appropriate audit evidence by carefully performing further audit procedures with professional skepticism.
- It is recommended that an engagement quality review be performed for the component auditor's work if it is appropriate in light of, for example, the degree of risks of material misstatement.

(Comments on 8(b))

We believe that the interactions between the group engagement team and component auditors throughout the different phases of the group audit are clear and appropriate.

(Comments on 8(c))

Identification and Assessment of a Risk of Material Misstatement

We agree that the group engagement team shall obtain an understanding of the group and its environment to lead risk assessment procedures on the group financial statements. On the other hand, we believe that it is very difficult in practice for the group engagement team on its own to undertake risk assessment procedures of the group financial statements in a complete manner.

Typical company groups involve segregation of duties in a hierarchical manner, depending on the size of the group. Although the management of the parent company is responsible for all the risks of the group, they do not completely grasp these risks, and instead, they take appropriate actions in accordance with the significance of those risks and the surrounding environment. For example, a group that has many subsidiaries all over the world often establishes regional headquarters and assigns regional executives to delegate the responsibility and authority of the parent company.

We believe this also applies in a group audit. Although the group engagement team is responsible for identifying and assessing all the risks of material misstatement of the group, the group engagement team's responsibility should be to design when and what audit procedures should be performed by whom, and to involve component auditors accordingly. In doing so, we should clarify how the group engagement team should delegate their responsibility and authority to the component auditors and what kind of responsibility the component auditors should take, when reinforcing the group engagement team's involvement in the component auditor's work. However, there is no specific guidance to clarify these matters. As a consequence, it may be interpreted to mean that only the responsibilities of the group engagement team would become excessively heavy, and we are concerned that this may make it difficult to achieve a high-quality group audit. We are also concerned that the group engagement team would be required to excessively participate in the risk assessment procedures.

For example, if an audited company group were operated under a common information system and/or business customs throughout the group, the group engagement team might be able to identify and assess risks of material misstatement in an appropriate manner. However, the languages and business customs used by each component in the group are often different. It is thus inferred that the component auditor has more knowledge about the component and its environment than the group engagement team. Therefore, the group engagement team is unlikely to be able to fully lead the risk assessment procedures of the group financial statements.

In particular, in the case of a large group audit with many components, we believe that we also need a concept of identifying significant components under certain criteria in parallel with the risk-based approach. In other words, in addition to the top-down risk assessment procedures performed by the group engagement team, the group engagement team should identify specific components under certain criteria that have significant effects on the group financial statements, and the component auditors for the identified components should undertake the bottom-up risk assessment procedures. This process is essential to the necessary and extensive risk assessment procedures and a high-quality group audit. Otherwise, we are concerned that the scope of risk assessment procedures might be expanded endlessly.

As described in paragraph A78, we agree the group engagement team's process of identifying and assessing the risks of material misstatement of the group financial statements is iterative and dynamic. We believe that practical guidance is necessary about how to achieve the bottom-up iterative risk assessment procedures, based on the outcome of the component auditor's procedures under the risk-based approach that concentrates authorities and responsibilities to the group engagement team.

Further Audit Procedures

ISA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” paragraph 33 describes audit procedures required to be performed, irrespective of the auditor’s assessment of the risks of management override of controls. We believe that it is necessary to provide practical guidance on who should undertake these procedures and to what extent (in particular, journal entry testing and procedures for management bias) in a group audit under the risk-based approach.

ED-600 paragraph 49 requires the group engagement team to evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed not only by the group engagement team themselves but also by component auditors, but we are concerned whether this is practically feasible under the risk-based approach. It is unclear how detailed the group engagement team needs to evaluate the obtained audit evidence to express an audit opinion on the group financial statements, under the proposed approach to enhance the group engagement team’s involvement in the work of the component auditors.

Others

ISA 315 (Revised 2019) “Identifying and Assessing the Risks of Material Misstatement” paragraph 36 states “for material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the auditor shall evaluate whether the auditor’s determination remains appropriate.” We believe we need practical guidance for a complex and large group audit.

We also believe that we need practical guidance for the sub-consolidation cases about how the group engagement team should be involved in the risk assessment procedures of sub-consolidated subsidiaries, what kind of responsibilities the component auditor for the sub-consolidated financial information takes, and how the component auditor works with the group engagement team.

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

(Comments)

We are concerned that the illustration of paragraph A5 may be misunderstood to mean that several entities could be combined into a single or a smaller number of components in all cases if the information systems and systems of internal control are common. In order to avoid such misunderstanding, this application material should be removed or more detailed additional explanations should be provided.

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?

(Comments)

We support the focus on component performance materiality. We make the following comments on the definition of aggregate risk.

Aggregate risk is defined in paragraph 9(a), but the current explanation is not sufficient. With the statement “exists in all audits” in paragraph A11 in mind, more detailed explanations should be provided in order to clarify whether any of the following is meant or not.

- 1) Risks that a material misstatement cannot be detected as an audit procedure is performed based on testing some selected items in a population
- 2) Risks that a material misstatement cannot be detected for classes of transactions, account balances or disclosures where no risk of material misstatement is identified

Considering this from the perspective of the group audit, the following risk is also assumed.

- 3) Risks that a material misstatement cannot be detected regarding financial information of the component where no risk of material misstatement is identified

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?**

(Comments on 11(a))

Paragraph 43 requires the group engagement team to communicate with the component auditors about their responsibilities and the group engagement team’s expectations. We believe that this communication should be documented. Alternatively, we suggest that an application material describe the usefulness of its documentation, even though it is not a requirement.

(Comments on 11(b))

We agree with the proposal.

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

(Comments)

See our comments on individual paragraphs below.

Other Comments on Individual Paragraphs of ED-600

- Paragraph 9(j)

The description after “who are responsible for” in the definition of the group engagement team states the roles of the group engagement team, not the definition itself. For example, it seems to suggest that individuals who are members of the parent company audit team but are not involved in any of these three areas (i.e., (i) Establishing the overall group audit strategy and audit plan, (ii) Directing and supervising component auditors and reviewing their work, or (iii) Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements) are not the group engagement team members, but we believe this is not appropriate.

- Paragraphs 16 and 17

In the case of the restriction on access imposed by group management (paragraph 17), it refers to a disclaimer of opinion. However, in the case of the restriction outside the control of group management (paragraph 16), it only refers to considering the possible effects on the group audit, and does not refer to a disclaimer of opinion. In either case, both are circumstances where sufficient appropriate audit evidence cannot be obtained. Therefore, we suggest the following revisions to paragraph 16:

- ✓ When there is a restriction on access, its effects on the group audit opinion should be considered, whether or not it is imposed by group management
- ✓ Audit opinion should be modified, if necessary, after considering the effects

- Paragraphs 37 and 38

Paragraph 37 contains a reference to paragraphs A96-101. However, because these application materials are also related to paragraph 38, we suggest moving the reference to those application materials to the heading “Considerations When Component Auditors Are Involved.”

- Paragraph 56(c)

While any limitations to the scope of the group audit are required to be communicated with those charged with governance, such as restrictions on access to people or information, we believe that practical guidance is needed on what is to be communicated, and to what extent, in practice.

- Paragraph A29

We believe that the third sub-bullet (i.e., requesting the component auditor to prepare a memorandum) and the fourth sub-bullet (i.e., discussing the procedures performed) under the first bullet (i.e., when laws or regulations restrict sending relevant audit documentation across borders) are not appropriate examples because they do not

enable audit documentation itself to be accessed.

- Paragraph A51

The beginning part “the nature timing and extent” should be “the nature, timing and extent.”

- Paragraph A55

ISA 315 (Revised 2019) paragraph 14(a) requires inquiry of individuals within the internal audit function as risk assessment procedures. To be consistent with this requirement, we suggest adding individuals within the internal audit function as counterparties to inquiry under paragraph A55 of ED-600.

- Paragraph A81

We suggest adding “with consideration of inherent risk factors” to clarify the reason for referring to Appendix 4 that illustrates examples of inherent risk factors.

- Paragraph A83

It is unclear what “preferred audit techniques or methodologies” means specifically.

- Paragraph A88

This paragraph provides an illustration for determining that the financial information of several components can be considered as one population, but it is difficult to understand from the following perspectives, so we believe additional explanations are necessary.

- 1) Based on the description in paragraph A5, those entities are considered as a single component in the first place since the risks of material misstatement and systems of internal control are common among the entities in the case of paragraph A88.
- 2) There is a wide range of interpretations about what kind of transactions we consider to be “homogenous,” so we are concerned about confusion.

- Paragraph A89

This paragraph states “the group engagement team may have identified a significant class of transactions, account balance or disclosure in the group financial statements that comprises classes of transactions, account balances or disclosures at many entities and business units, none of which individually result in a risk of material misstatement at the group financial statement level.” In this case, it is suggested that the engagement team perform audit procedures at selected components. However, practical guidance is necessary about which components should be selected specifically.

- Paragraph A91

From the perspective of responses to risks of material misstatement due to fraud, considering the description of ISA 240 paragraph 30(c), which has been referred from ED-600 paragraph A91, “unpredictability” means what the entity does not predict. We believe that “the extent to which the group engagement team is involved in the work” is not an appropriate illustration.

- Paragraphs A96-101

Considering paragraphs 29 and A52-53 of the extant ISA 600, the extent to which the group engagement team is involved in the work performed by the component auditors will differ between significant components and other components. Similarly, we suggest that ED-600 also include an illustration showing that the extent to which the group engagement team is involved in the work performed by the component auditors differs, depending on the extent to which a component’s financial information affects the group audit. For example, illustrations in the following cases may be useful.

- ✓ Identifying a significant risk of the group financial statements in the financial information of a component
- ✓ Financial information of a particular component constitutes a significant portion of the group financial statements

- Paragraph A97

Paragraph A97 suggests three ways of component auditor involvement (i.e., (i) designing and performing further audit procedures on the entire financial information of the component, (ii) designing and performing further audit procedures on one or more classes of transactions, account balances or disclosures, (iii) performing specific further audit procedures as identified and communicated by the group engagement team). Depending on the ways, the communication between the group engagement team and the component auditors should be different in nature. Also, in the extant ISA 600, depending on whether a component is a significant component or not, the communication with the component auditor should differ. We therefore suggest adding explicit explanations about the differences in communication, depending on how the component auditor is involved and how significant the component is.

- Paragraph A104

We believe that it is inappropriate to refer to an auditor who performs a statutory audit as a “component auditor.”

- Paragraph A113

When the group engagement team reviews the component auditor’s audit documentation, paragraph A113 suggests factors affecting the nature, timing and extent of the review; we suggest clarifying the extent to which the review should be performed in the first place. Otherwise, the scope of the audit documentation, which is subject to

the group engagement team's review, may be expanded endlessly, or the component auditors may always be required to prepare their audit documentation in languages that can be understood by the group engagement team, both of which would be enormously burdensome.

- Paragraph A124

As an example when the group engagement team determines that it is appropriate to include certain parts of the component auditor's documentation in the group engagement team's audit file, paragraph A124 suggests a case of documentation of significant matters addressed by the component auditor that are relevant to the group audit. However, it is unclear what issues would arise if the group engagement team does not include it into the group engagement team's audit file in the first place.

Paragraph A130 suggests that the group engagement team's audit documentation include a general description of the works performed by the component auditor, when the component auditor is restricted from providing documentation outside of its jurisdiction. However, it should be clarified whether similar responses are sufficient even when there is no such restriction.