

International Auditing and Standards Assurance Board
IAASB
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02 October 2020

Comment letter relating to the IAASB's Exposure Draft - ISA 600

Dear Board Members,

1. IAASA appreciates the opportunity to comment on the IAASB's Exposure Draft, Proposed International Standard on Auditing (ISA) 600 (Revised), Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors) ("ED 600") issued in April 2020.

Overall comments

2. IAASA supports the IAASB project to revise ISA 600 to enhance provisions applicable by auditors in audits of group financial statements.
3. We particularly support the following changes made:
 - Alignment of the risk-based approach in ED 600 with the recently revised ISA 315;
 - Further emphasis on the applicability of all ISAs for an audit of group financial statements and clearer links between ISA 600 and other ISAs; and
 - Revised structure to outline the requirements for situations where component auditors are involved, which is intended to help application of ED 600 to group audits of different complexity.
4. Although IAASA is generally supportive of the ED 600 proposals, we believe that several aspects of the ED 600 should be further improved as described hereafter.

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Risk-based approach

5. We are supportive of the introduction of the risk-based approach in auditing the financial statements of a group and greater alignment with the requirements in ISA 315. The risk-based approach in ED 600 requires the group engagement team to determine the significant classes of transactions, account balances and disclosures in the group financial statements and to identify and assess the related risks of material misstatements of the group financial statements.
6. However, we are concerned that the group engagement team might perform a centralised risk assessment without giving adequate consideration to the involvement of component auditors (e.g. without choosing to assign work to them, as described in paragraph 25). Paragraph A79 and Appendix 1 provide guidance on the involvement of component auditors. However, there is no requirement in ED 600 to make use of the experience of component auditors and to benefit from their knowledge about the economic, legal and social framework in which the components operate. If component auditors are involved, we suggest requiring the group engagement team to request their input as part of the risk assessment process and where deemed necessary in the design of further audit procedures, including where the group engagement team decides to perform these tasks centrally.
7. More generally, we are of the view that the introduction of the new risk-based approach proposed in ED 600 will require a substantial change in mind-set for auditors and the IAASB should consider what additional guidance can be provided to assist with this shift and to help auditors and audit firms to embrace the new mind-set. For example, the standard refers to the risk-based approach for determining the work efforts required to assess component auditors' work, but it does not contain clear provisions on how that risk-based approach impacts the actual procedures to be performed by the group engagement team.

Linkages with other standards / Relationship with other standards

8. We support the changes made to address the interaction between ISA 600 and the other ISAs with additional emphasis on key aspects of other standards. The alignment in approach of the proposed standard with other recently issued standards is also acknowledged. However, the explanatory memorandum is clearer than ED 600 that the full suite of ISAs are the foundation on which ISA 600 is based. In introductory paragraphs 1 and 2 of ED 600, the statements that "The requirements and guidance in this ISA refer to, or expand on, how other relevant ISAs are to be applied in relation to an audit of group financial statements" and "This ISA applies when the auditor had been engaged to audit group financial statements" could be read as stating that only ISA 600 and the ISAs referenced in ED 600 are relevant for group audits. ED 600 needs to make it clear in the requirement section that the special considerations set out in ISA 600 are in addition to those in the other standards. We further recommend specifying the reasons for including references to specific ISAs in ED 600 and for not addressing others.

9. In a similar vein, the statement in introductory paragraph 6 that the group engagement partner is ultimately responsible for compliance with ED 600 should be changed to a requirement clarifying that the group engagement partner should ensure compliance with all the ISAs that are applicable to the group's circumstances.

Scope and Definitions

10. ED 600 (paragraph 3) allows the auditor to plan and perform the group audit in a way that is not “[...] necessarily aligned with how group management views the entities or business units comprising the group”. It should be made clear in the standard that the group auditor should take into account the reporting processes of the group and the financial information as collected and prepared by the components defined by group management and they should evidence the professional judgments applied in reaching their conclusions as to the most appropriate scoping for audit purposes. We suggest further clarifying the impact of this progressive approach on the auditor’s risk analysis and controls testing as well as audit approach and providing guidance on when bypassing the group structure may be appropriate.
11. The scope of ED 600 has been clarified in terms of the definition of group audit, group financial statements and the reference to the consolidation process. However, we believe that the definition of “consolidation process” in paragraph 11(b) should clearly exclude the aggregation of the financial information of branches or divisions when this aggregation results in preparation of financial statements of a single legal entity, which would not be subject to a “group” audit, but to a “single entity” audit.

Acceptance and Continuance

12. Paragraphs 16 and 17 in conjunction with paragraph A29 could be read that a discussion with the component auditor about the procedures performed is sufficient by itself for the group auditor to rely on those procedures to overcome restrictions on access to information or people. Similarly for entities accounted for using the equity method, paragraph A29 could be read that access restrictions might be overcome by considering information as the sole procedure. In our view these procedures alone do not satisfy the requirement to obtain sufficient appropriate audit evidence.
13. Paragraph 19 requires a confirmation from the component auditor about their willingness to cooperate with the group engagement team. We believe that the group engagement team should also be required to request the component auditor to confirm that it will conduct its work as directed by the group engagement team. Therefore, paragraph A35 should be mandatory and elevated to a requirement. Additional provisions are also needed to address scenarios

where the component auditor is not able to confirm (full) cooperation, for example in cases where national law imposes restrictions on sharing audit documentation or certain data.

14. Paragraph 20 addresses ethics and independence related matters. We suggest including the requirement in paragraph 20(c) in paragraph 44 as it relates to communication by component auditors. We think that the confirmation from component auditors that the ethical requirements including those related to independence have been fulfilled should be obtained at the beginning of the audit as well as during the conclusion phase. We also suggest clarifying the link between paragraph 20 and the confirmation of compliance with ethical requirements including those related to independence in the corresponding application material. Further we are of the view that the component auditors' confirmation of compliance with ethical requirements including those related to independence should be in writing.
15. Paragraph 21(b) should require, where the results of external inspections are not provided, the group auditor to request confirmation from the component auditor that there has not been a recent inspection or that there were no significant findings or recommendations arising from such an inspection. This would contribute to the assessment of the competency and capability of the component auditor by the group engagement partner as required by paragraph 21(a).
16. The level of involvement of component auditors should be determined by the group engagement partner at a sufficiently early stage to ensure proper communication and performance of procedures at component level. Before accepting the assignment, the group engagement partner also needs to take into account the requirements of the ISAs and the need for appropriate and timely planning and coordination. In the particular circumstances of late-appointment of the group auditor, and where the component auditors have already finalised their work on the statutory accounts of group entities, ED 600 should further emphasize (e.g. in paragraphs A21-25) that the group engagement partner shall decline the group audit assignment if the timeframe and completion date do not allow the group engagement team to gather sufficient and appropriate audit evidence as required, which may include additional work by the component auditors.

Materiality

17. ED 600 provides little guidance for determining component materiality (paragraphs 29 and A73 to A77), which may lead to wide variation in practice regarding the determination of component materiality. We urge the IAASB to provide further explanations and illustrations on the determination of component materiality (e.g. minimum or maximum positions / ranges, etc.) and add extensive descriptions and/or give practical examples of aggregations risks. Without further guidance consistent application of ED 600 will be difficult to achieve.

Identifying and Assessing the Risks of Material Misstatement

18. Extant ISA 600 addresses the consolidation process which is one of the areas where there have been recurring inspection findings by a number of members of the Committee of European Auditing Oversight Bodies (“CEAOB”), of which IAASA is a member. The topic of consolidation is very important. The auditor should take the consolidation process into account to understand the company and its financial and operational processes, as well as when assessing identified risks of material misstatement. Hence, further emphasis on the consolidation process could be useful in the Identifying and Assessing the Risks of Material Misstatement section of ED 600.
19. Additionally, we note that fraud can occur via consolidation adjustments. We are of the view that reference to fraud risks and tendencies for fraud when addressing consolidation would be useful beyond paragraph A80. Hence, we also suggest including an explicit reference to ISA 240 in the Identifying and Assessing the Risks of Material Misstatement section of ED 600 when addressing consolidation.

Responding to the Assessed Risks of Material Misstatement

20. We believe that the requirement of paragraph 34 should be that the group engagement team not only “take responsibility” for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. The team, with the involvement of the component auditor(s) where deemed necessary, should also “design and perform” those procedures, including those stipulated in subparagraphs (a) and (b).
21. Paragraph 38 states that for areas of higher assessed risks, including significant risks, the group engagement team shall evaluate the appropriateness of the further audit procedures determined by the component auditor. This requirement should be aligned with the provisions of paragraph 23 which include “areas of higher assessed risks of material misstatement of the group of financial statements, or where a significant risk has been identified and areas in the group financial statements that involve significant judgement.”
22. Additional provisions in ED 600 should also explain how paragraph 18 of ISA 330, requiring the group engagement team to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, shall be considered in a group audit setting.
23. ED 600 should also clarify how to apply paragraph 10 of ISA 500, which deals with the selection of items to obtain audit evidence in the context of a group audit. It is unclear in ED 600:

- If a significant risk at group level is identified, whether further audit procedures shall apply to all components affected by this risk or whether a sampling approach could be applied to components provided that the conditions required by ISA 530 are met at the level of the components; and
- When designing and performing substantive audit procedures (by component auditors and group engagement team) for each material account balance, class of transactions and disclosures, whether the group engagement team shall ensure that the remaining untested account balances, class of transactions and disclosures remain below the group performance materiality.

This aspect is particularly important when a group is composed of a several small individual components that cannot be grouped within one component for the purposes of further audit procedures to be performed and when audit procedures cannot be performed centrally.

Two-Way Communication Between the Group Engagement Team and the Component Auditor

24. Setting clear and sufficiently detailed instructions for the component auditors is fundamental for the planning and performance of the group audit as it will be the basis for the direction of the component auditors by the group engagement team throughout the audit engagement. Therefore, we are of the view that ED 600 (e.g. paragraph 43) should specifically require written instructions.
25. Paragraph 44 includes a list of items that the group engagement team is required to request the component auditor to communicate. Other topics to report to the group engagement team could be areas of significant judgement made by the management of the component. For example, the assumptions made by the management of the component in a scenario analysis or application of discount rates that are at the lower or upper end of the range stipulated by the group. Similarly, provisions for litigation/law suits that are within reasonably expected outcomes at component level, might be assessed differently by the group engagement team.
26. We also suggest including the following matters in the requests for communication detailed in paragraph 44:
 - Details and results of the component auditors 'risk assessment procedures on the risks of the component that are relevant at the group financial statements level (beyond what is referred to in paragraph 25 of ED 600);

- Details and results of the component auditors' work where the component auditor is involved in the identification and assessment of the risks of material misstatement of the group financial statements referred to in paragraph 32;
 - Communication referred to in paragraph 37 between the group engagement team and the component auditor of matters that are relevant to the design of responses to the assessed risks of material misstatement; and
 - Communication on the detail of the further audit procedures (and of the related findings and conclusions) referred to in paragraph 38 that are designed and/or performed by the component auditors on areas of higher assessed risk of material misstatement of the group financial statements, including significant risks and areas that involve significant judgment.
27. Through reference to the matters in paragraph 44 of ED 600, instances of non-compliance with laws or regulations are covered. However, paragraph 44 only refers to the component's compliance, and also it is unclear what the threshold is for non-compliance matters that are to be documented by the group auditor. We encourage the IAASB to add further detail regarding the scope and the threshold.
28. Paragraph 28(b) refers to communication by the group engagement team to all component auditors of any events or conditions that may cast significant doubt on the "group entity's" ability to continue as a going concern reported by a component auditor. Paragraph 41(b) is understood as a request by the group engagement team to the component auditor to report any events or conditions that may cast significant doubt on the group entity's ability to continue as a going concern. However, the phrase "group entity" in these paragraphs requires further clarification as it is unclear if the term refers to the component(s) for which the component auditor is responsible or the overall group.

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

29. Paragraphs 49 and A115 highlight the fact that the evaluation of the sufficiency and appropriateness of audit evidence obtained during the group audit (which is required by other ISAs, and, hence also applicable to group audit situations) shall be "including with respect to the work performed by component audits". We believe these provisions are welcome but should be enhanced to further stress the requirement for the group auditor to appropriately evaluate audit evidence stemming from the work of component auditors and to clarify the level of review required on the procedures performed by component auditors to gather this evidence. They should also re-emphasise the need for the group engagement team to consider both contradictory and confirmatory evidence and to take aggregation risk into account.

Communication with Group Management and Those Charged with Governance (“TCWG”) of the Group

30. Paragraphs 53 to 56 on communication with TCWG do not address communication regarding ethics and independence of the group auditor and component auditors, nor any statements to be made in this regard. Additional provisions should be added in ED 600 to cover communication with TCWG in a group audit situation regarding ethics and independence.

Review and Documentation

31. Paragraph 23 sets out considerations for the group engagement partner when taking responsibility for the nature, timing and extent of direction, supervision and review of component auditors and their work. Paragraph 45(b) states that the group engagement team is required to “determine whether, and the extent to which, it is necessary to review parts of the component auditor’s audit documentation”. Weaknesses in the review of component auditors’ work by the group engagement team is a concern identified during inspections by audit regulators, which highlights a deficiency in the extant ISA 600. In the ED 600, we note there is still limited guidance on the review expected. In our view these provisions, associated with the application material, are still insufficient to determine the level of review needed and should be further developed. We encourage the IAASB to clarify to what extent the group engagement partner or group engagement team should review certain specific component related working papers and other forms of audit documentation. In particular, we recommend that the IAASB explores situations in which a review of the component auditor’s work should be mandatory, such as for areas listed in paragraph 23(a) and (b) of ED 600 or where the group engagement team audits only a small portion (or even no portion) of the group’s operating business. It should be applicable regardless of whether or not the component auditor is a member of the group engagement team’s network.
32. Deficiencies in documentation are also a key concern identified during many inspections by audit regulators. We suggest adding an explicit reference to compliance with ISA 230 in the text of ED 600 and elaborating further on the specificities of group audit in this regard, especially with regard to the need to document the group engagement team’s conclusions drawn from component auditors’ procedures to enable an external evaluation (e.g. by the audit oversight bodies).
33. Taking into consideration our previous comments, additional audit documentation should be required on the group audit file (paragraph 57 of ED600) such as:
- State and document the group engagement team’s rationale for the audit documentation of the component auditor selected for review. This provision is currently included in paragraph A126 of the application and other explanatory material and should be elevated to a requirement;

- State and document the nature, timing and extent of the audit procedures performed by the component auditor (including relevant audit evidence obtained by the component auditors) that have been reviewed by the group engagement team;
- State and document the result of those reviews, including, where necessary, the follow-up on the outcome of those reviews;
- Emphasis that the documentation included in the group audit file should be sufficient to enable an evaluation whether the group engagement team has obtained sufficient and appropriate audit evidence (including on the work performed by component auditors) on which to base the group audit opinion; and
- Document the procedures performed when assessing the competence and capability of the component auditor and the result of those procedures (refer to paragraph A41).

34. This audit documentation concerning the review of the work performed by component auditors could take the form of a written memorandum or report prepared by the group engagement team.

35. We further invite the IAASB to elaborate, in the documentation section, on cross border issues and the delineation between the component auditor's and group auditor's files. In this regard, including specific provisions regarding the documentation required when component auditors are involved could be helpful.

Consistency with European provisions

36. We draw the IAASB's attention to the provisions of European Union legislation applicable to auditors in Ireland and throughout the EU in areas covered by ED 600. Any requirements which are inconsistent with the legal framework in force would impair the application of the revised ISA 600 in Ireland and other countries applying European Union legislation.

37. In particular we want to highlight the specific provisions in relation to group audit procedures to be performed under Article 27 of Directive 2006/43/EC (Audit Directive):

- The group auditor's full responsibility for the audit report issued on the consolidated financial statements;
- An evaluation by the group auditor of the audit work performed by the component auditor(s) for the purpose of the group audit is required;
- Nature, timing and extent of work performed by component auditors needs to be documented in the group audit file;
- Requirement to document the group auditor's review of relevant parts of the audit work performed by component auditors;

- The documentation retained by the group auditor shall be sufficient to enable the competent authority to review the work of the group auditor;
- Group auditor to request the agreement of the component auditors to the transfer of relevant documentation during the conduct of the audit;
- Group auditor to take appropriate measures and inform the competent authority if unable to review component auditors' work performed for the purpose of the group audit;
- Retaining any working papers relevant to the group audit in the audit file or obtaining the component auditor's agreement to give unrestricted access; and
- Group auditor to undertake procedures to gain access to audit documentation and evidence thereof.

Post implementation review of the revised standard

38. We also encourage the IAASB, following completion of this project, to gather stakeholder input via a post-implementation review in order to assess whether the changes have achieved the desired effects and how the shift in mind-set was embraced (e.g. whether the goals have been met and whether some challenges remain).

Please do not hesitate to contact me, should you have any questions on the content of this letter.

Yours faithfully,



Kevin Prendergast

Chief Executive