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KICPA's Comments on IAASB's Exposure Draft on Proposed International Standard on Auditing 600 (Revised), Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors)

Dear Willie Botha,

The KICPA is pleased to have an opportunity to comment on the Exposure Draft issued by the International Auditing and Assurance Standards Board for Accountants (IAASB), regarding the Proposed International Standard on Auditing 600 (Revised), Special Considerations – Audits of Group Financial Statements (including the Work of Component Auditors). KICPA is a strong advocate of IAASB for your relentless efforts to serve the public interest by setting high-quality international standards for auditing, assurance, and other related standards, and by facilitating the convergence of international and national auditing and assurance standards.

Specific Questions

Please see the below for our responses to the 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).

We believe the scope and applicability of ED-600 is, in general, clear, and also support the definition of group financial statements, including the linkage to a consolidation process.

Aside from this, we believe ① more specified and clarified explanations, using diagrams as to examples on under which circumstances entities are subject to audits of group financial statements, would be necessary, as it is difficult for a single entity to determine whether it is subject to audits of group financial statements or not on its type basis. ② It is not clear either as to under which circumstances the proposed ED-600 is applicable to, thereby creating a need for providing specified examples (e.g., ③ a SSC not producing financial information, ④ using a SSC outside the entity, ⑤ an in-house SSC of a single entity whose works are directly performed by the group auditor etc.) and the application material.

The concept of group is expanded to cover that of aggregation of the financial information. Given that for now the extant ISAs do not include requirements applied to an entity, subject to the concept of aggregation but with no consolidation process, it would be necessary for the

Board to consider including paragraph 2 of extant ISA 600 of “An auditor may find this ISA, adapted as necessary in the circumstances, useful when the auditor involves other auditors in the audit of financial statements that are not group financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location” to the ED-600.

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?

① We believe ED-600 develops requirements and the application material to make it fit with complex audit environments for groups that exceed a certain amount of sizes and have features of IFRS adoption, operation of internal controls in accordance with COSO, and build-up of relatively strong those charged with governance etc. However, SMPs performing audits of group of financial statements of small companies (comprising the most part of the economy), not subject to the above thresholds, face difficulties with identifying which part of their works are applicable to ED-600 or not and conducting audits accordingly. To address such difficulties, as we believe, it would be necessary to provide examples of items small entities are required to apply and selective items whose application is based on auditors’ professional judgements in ED-600, along with illustrative examples for SMEs.

② In addition, when considering comprehensive requirements across ED-600, the focus is made on the risk-based approach of the group auditor, thereby raising a concern that the engagement of component auditors could be limited in a passive manner. We are with the eventual enhancement of group auditor’s responsibility in group audits, but we suggest the Board consider enhancing the role and responsibility of component auditors as well by including how the group auditor controls component auditors in dividing the responsibility

for group audit failures, arising from faults committed by component auditors (e.g., inclusion of right of indemnity in the group audit engagement contract, in case of the occurrence of legal liabilities caused by faults of component auditors).

③ In case of big-sized, complex groups audits, it would be difficult for the group engagement team to conduct risk assessments on all of the components and communicate all of them with component auditors, which would end up with limiting the scalability of the standard.

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 revision of terms suggested as an entry point into group audits in ED-600.

However, the adoption of the revised ISA 600 in practice is expected to bring about following challenges. The management is the one who has the highest level of understanding on the location, function and activity of an entity, and the responsibility of preparing group financial statements, performing risk assessments and controlling risks go to the management. Then, describing “by auditors” in the definition of terms could mean that what is defined by auditors are irrelevant from risk assessments that are supposed to be appropriately performed by the management, and the role and duty of auditors increase as for the identification of components that cannot be performed by the management, thereby creating substantial difficulties to apply audits in “components” defined by auditors.

Consequently, audit procedures on what is defined by auditors (irrelevant from the management) could increase work burdens in practice, as we expect. To address such burdens, we believe the following would be necessary: (1) components, including those operated by the

management, should be determined via deliberations between the management and auditors or (2) various examples to suggest criteria on components in which auditor's judgments are exercised should be provided. For instance, various examples on how to determine components need to be provided, as there are some cases lacking clarity in how to determine components as for the combination of locations, functions or activities (e.g., ① an entity operates business units A and B, ② business unit A performs operations in Europe and Asia, and business unit B only in Europe, and ③ in Europe only HR function is performed at a shared service center and the rest functions are performed at the respective jurisdictional level, and in Asia all of the functions are performed at the respective jurisdictional level).

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?

We support the improvement of requirements and application material of ED-600 to address restrictions on access to information and people along with how to overcome such restrictions.

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?

The responsibility of the group engagement team is specified and clear, but in case component auditors don't perform their work appropriately, it is not clear who is responsible for. Then, the excessive workloads and responsibilities are likely to mostly go to the group engagement team in the following cases: ① when component auditors don't perform their works appropriately, assigned from the group audit plan; ② component auditors overlook frauds committed by the management; and ③ there is a restricted access to documentation prepared by component auditors.

In addition, the risk of material misstatements of group financial statements should be identified, not only from the perspective of the group auditor (top-down) but from that of component auditors (bottom-up), which would result in sufficient assessment of audit risks of group financial statements. Given this, more clarified and specified definition on the role and responsibility of group auditors should be provided, as we believe.

(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?

We believe the proposed ED provides clarity about the interactions between the group engagement team and component auditors throughout the different phases of the group audit, but lacks clarity as to when the interactions must be done. Sure, the timing of the interactions could be decided, based on the professional judgments of the group engagement team. However, there might be a limit in the interaction, in case other accounting firms are used as component auditors or an entity is big-sized and complex. This means that the lack of clarified requirements could invite the following cases: ① the interaction could be done just once as a courtesy form, thereby creating a concern over audit quality; and ② communications could be frequently made at the occurrence of the event, thereby significantly increasing work burdens. It would be great helpful for the Board to provide examples and explanations about to which extent and in which area the group auditor should engage in audit procedures, taken by component auditors specifically at the respective phase of audit procedures, which would be beneficial for the effective and useful interactions.

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

- ① The extant approach identifies what is financially important in group financial statements as significant, thereby being able to decrease the total risks via communications with component auditors who have a high level of understanding on components. Based on the revised ISAs, in case the group auditor, who has, anyway, a certain level of limit in their understanding on components, performs risk assessments at a group financial statements level from the stage of audit planning, however, the group auditor is likely to fail to identify

the characteristics of subsidiaries and risks of the respective ones, especially when the group audit is big-sized, complex, consolidating dozens or hundreds of subsidiaries. As a result, the group auditor has a difficulty with providing clarified and specified instructions on audit procedures and component auditors have to communicate anomalies of subsidiaries at the occurrence them, thereby creating a possibility of changes in the scope of work demanded by the group engagement team to component auditors accordingly, which is expected to cause difficulties on component auditors' development of the component audit plans and performance of audit engagements.

② Then, component auditors also have a difficulty in coming up with necessary plans in advance. Give such difficulties, we believe, the newly adopted audit methodology provide clarified guidance as to how the risk-based approach could specifically apply at the respective phase of what, how, by whom and where, described in the paragraph 50 of ED-600. Applying the risk-based approach at the respective phase as above and providing templates for planning group audits and examples of how to implement them, along with examples of how the approach is exceptionally applicable to less-complex small entities, would be helpful in implementation.

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 application material on the commonality of controls and centralized activities from the perspective of maintaining and achieving the quality of group audits, as the group management designs controls that are operated in a common manner across multiple entities or business units and expands the provision of centralized services on a certain activities for efficient management. As for the application material, we would like to suggest the Board provide various examples and the additional application material, taking into account SMPs that have difficulties with identifying the commonality of controls and centralized activities

and responding to them accordingly.

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?

We support the focus on component performance materiality taking the risk-based approach, since the management of the total risks in audits of group financial statements is highly likely to be practically conducted in the audit procedures, related with classes of transactions, account balances and disclosures. In addition, we are also for the additional application material on what needs to be considered to support auditors make a judgment on the total risks and component performance materiality, taking into account the characteristics of the respective groups.

However, we concern that ISAs do not provide methods on how to measure materiality, thereby allowing accounting firms to apply their own materiality measurement methods, which ended up with huge differences in the amount of materiality among accounting firms, being likely to create problems in the review of audit quality. As discussed in the webinar on August 13th, it would be more useful for the Board to provide various examples to support auditors measure materiality, based on their professional judgments on a component type basis (location, function or activity) and on a business type basis (e.g., component in which revenues matter, component in which assets matter), by including the measurement method to the principle based guidance, related with the total risks and the measurement of the component performance materiality.

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?

We believe most of the matters regarding documentation are sufficiently described in paragraph 57. In addition, we would like to recommend more clarity on the following matters:

① whether video clips, such as webinars, or audio files, such as mp3, should be included in documentation; ② the proposed ED requires the group engagement team to make a decision on component auditor working papers that are included in working papers of the group engagement team, exercising professional judgments, then, more clarity should be made as to what to consider for the decision. For one, paragraph 124 indicates that all of the component auditor's audit file don't need to be replicated in the group engagement team's audit file, but documentation on the outcome of risk assessments is necessary, considering that component auditors are considered a part of the group engagement team, then more clarity should be made on what needs to be considered from the perspective of professional judgement, in relation with such documentation; ③ more clarity should be made as to whether the conclusion on the risk assessment has to be documented in the working papers of the group financial statements, when risk assessment procedures are assigned to component auditors (A83).

(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?

We support the application material relating to the group engagement team's audit documentation, when access to component auditor documentation is restricted.

However, we suggest the following improvements: ① more clarity should be made as to - in such a case, whether it would be okay to make a conclusion that audit evidence is sufficiently obtained on the works performed by component auditors, or in such a case the group engagement team has to perform additional works on the relevant components; and ② more clarified guide should be provided on the memorandum describing the works performed by component auditors.

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

In relation with the application of the revised ISA 220, the definition of engagement team's terms is revised, thereby including component auditors in case of group audits, which makes ED-600 include the group engagement team and all of the component auditors when referring to the engagement team. However, law and regulation at a certain jurisdictional level prohibit component auditors from being included in the group engagement team, which serves as a stumbling block to adopting the revised ISA 600 in some jurisdictions.

Considering the challenge, we suggest the Board provide clarity and specification as to what needs to be considered in applying ED-600 in countries putting such law and regulation in place, if the revised ISA 600 considers the scenario.

We hope our comments would be helpful in your efforts to revise the International Standard on Auditing 600. Please feel free to contact us via cheekim@kicpa.kr for further inquiries.