

October 2, 2020

IFAC Small and Medium Practices Advisory Group Response to the IAASB's Exposure Draft, Proposed International Standard on Auditing 600 (Revised) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)* and Proposed Consequential and Conforming Amendments to Other ISAs

INTRODUCTION

The SMP Advisory Group (SMPAG) is pleased to respond to the IAASB (the Board) Exposure Draft (the ED), Proposed International Standard on Auditing 600 (Revised) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*. The SMPAG is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small- and medium-sized entities (SMEs). The constituents of the SMPAG are small- and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members and Technical Advisers serving the SMPAG are drawn from IFAC member bodies representing 22 countries from all regions of the world.

GENERAL COMMENTS

ISA 600 (Revised) is an important ISA within the suite as it forms the foundation for performing an audit of a group. It is therefore critical that it can be operationalized for group audits of all sizes and complexities and remains fit for purpose. The SMPAG has appreciated the engagement with the task force as the proposals have been developed and had previously [responded](#) to the IAASB Invitation to Comment.

The SMPAG generally supports a risk-based approach to planning and performing the audit of the group financial statements. However, we have received concerns that some of the proposals may reduce the quality of group audits in some cases, disrupt audit markets in some countries and potentially have unintended consequences which disadvantage SMPs.

In some jurisdictions, practitioners consider that removing the requirement for an audit for significant components and allowing the Group Engagement Team (GET) to elect to perform all risk identification, assessment and responsive procedures, without recourse to component auditors could be detrimental to audit quality of the group financial statements in some situations. The risk identification and assessment procedures for particular classes of transactions, account balances or disclosures may not be sufficiently effective at the GET level (i.e., without recourse to component auditors' potentially more extensive knowledge of components), which would in turn impact the design and performance of risk response procedures, thus increasing the risk that material misstatements (in particular, those resulting from fraud, non-compliance with laws and regulations, and going concern issues at component level) of the group financial statements will not be detected. Therefore, suitable requirements need to be set to ensure that GET draw on the sufficient knowledge of significant components (usually via component auditor's involvement) when appropriate. The SMPAG does, of course, appreciate that using a risk-based approach when planning and performing a group audit does not preclude an assessment of significant components and involvement of component auditors and that this may not be necessary in some group audits, but

believe the standard would benefit from a requirement to ensure this is the case where it continues to be appropriate, rather than be silent thereon.

There are some concerns that the proposed top-down approach could also lead to group auditors using the work of component auditors less than under extant ISA 600 or – where used – to select different component auditors for the group audit than at present (i.e. their own firm will be the first choice) – also potentially to the detriment of SMPs who would then be less often engaged to act as component auditors. This issue relates to ISA 220's inclusion of component auditors within the definition of engagement team, which as a result poses practical issues for the nature, timing and extent of the GET's direction, supervision and review of component auditors. This stems from the fact that a GET does not have the same ability in practical terms to extend the GET firm's incentive and disincentive measures inherent in that firm's quality management system to individuals from another firm – especially a firm that is not in the same network as the firm of the group engagement team.

The proposals may also unintentionally lead to a change in perception of the value of the statutory audit (in practical terms, clients may have to pay for work on components during group audits and again for (separate) statutory audits of components), possibly leading to less audits being required by local laws (where there are options) and thus have a significant impact on the audit market, potentially to the detriment of SMPs who would lose the statutory audits and may ultimately even exit the market – although this could be jurisdiction specific. There may also be a public interest issue concerning the impact on the audit markets – especially since the top-down approach to direction, supervision and review may adversely impact the use of SMPs from outside networks for work on components. Auditing standards should not drive anti-competitive behavior. In this context, we note that the EU Commission has expressed firm views on audit market concentration issues.

The SMPAG thus urges the Board to carry out an impact assessment to quantify the cumulative impact of the ED, as well as that of ISA 220 (Revised) following its changes to the definition of GET and consider the potential unintended consequences of these proposals, as alluded to in the Board's previous agenda papers.

DETAILED COMMENTS

We have outlined our responses to the questions (in bold) in the ED below.

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?

Broadly, we believe ED-600 does have the appropriate linkages to other ISAs and also with the proposed ISQMs. As noted below, the inclusion of component auditors in the engagement team under proposed ISA 220 (Revised) remains problematical in a group audit situation, especially when the component auditors are from outside the firm of the GET or not within the same network and the GET decides to proceed with the group audit engagement without involvement of a component auditor.

(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?

As the Board will be aware from our [response](#) to the ISA 220 (Revised) ED, we believe that including component auditors within the engagement team poses potential difficulties for the GET. This may be detrimental to SMPs, especially if they are the component auditors within the group. The reasons why GET might not choose to use component auditors could include:

- Using component auditors - especially those from a different network (i.e., with different audit firm methodologies and quality management systems) - may demand more detailed work from, or result in practical obstacles for, the GET in terms of its direction, supervision and review responsibilities. Thus, a desire to circumvent such issues or just to control efficiency (and minimize costs) might fuel a reduction in external involvement as an immediate reaction. This might constitute an incentive for the GET to either perform work centrally or to seek to deal with members of the same office, firm, or network;
- A desire (also by the clients) to avoid complexities resulting from requirements pertaining to audit firm rotation in different jurisdictions, which may vary - making auditor selection across a group difficult to manage (i.e., it may thus be easier to involve only the firm of the GET across the group based on the applicable external rotation rules); and
- Component audits may be subjected to different deadlines for audit completion. Where the group audit deadlines are ahead of these for components' audits (desire to avoid possible delays etc.), meeting more stringent group reporting deadlines could be achieved more easily, if the GET chooses not to rely on work performed as part of a statutory audit at the component level. Instead of requesting the audit work to be "speeded up" in order to meet group reporting package deadlines, the GET could elect to perform the work itself; or request another team from its firm or network to perform selected procedures etc. The statutory audit for the component would then be completed subsequently and with no impact on the group audit – potentially calling into question the need for the audit at the component level.

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 have mixed views on this. Some practitioners are supportive of how the standard distinguishes between the GET and the component auditors' responsibilities where they are involved. Others are concerned that the layout may imply that there are a lot of add-ons for GET when component auditors are involved. Therefore, there is a risk that this may convey the message that the group audit would be simpler/easier/ less expensive etc. if the GET alone were to perform all, or as much as conceivably possible, of the audit work for the entire group.

Coupled with the concerns about potential audit quality aspects if component auditors are not used where it would be beneficial to do so, the IAASB may need to determine a mechanism for driving the group engagement partner's decision on engagement team composition (at engagement acceptance and continuance stage, but also consider the need for a specific re-evaluation at the more concrete audit planning stage subsequently) and to present it logically throughout the standard. Such mechanism could be a requirement applicable in all cases, or a conditional requirement applicable only when the factors that need due consideration (e.g., where groups have components in jurisdictions with significantly different laws and regulations, cultures, languages and business practices) are present. We encourage the Board to develop such factors or criteria and consider which mechanism might be most appropriate, bearing in mind that for audits involving non-global

activities with all components within a single jurisdiction such consideration might be expected to be fairly straightforward or possibly unnecessary.

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?

We believe that ED-600 appropriately reinforces the exercise of professional skepticism in relation to an audit of group financial statements while adopting a consistent risk-based approach that is in line with ISA 315 (Revised).

However, the emphasis on the overall role of the GET for audit quality in a group may have unintended consequences of diluting the sense of ownership by component auditors for the judgments and decisions made and on the exercise of professional skepticism.

In addition, implementation guidance on areas of the group audit where professional skepticism may need to be heightened has been proposed as an area where practitioners would welcome further support.

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 agree that the scope and applicability is sufficiently clear. In our view, the linkage to a consolidation process is helpful.

One of the issues the revision of this standard sought to address was erroneous non-application of ISA 600 to the audit of financial statements of a single entity. The title of ED-600 (whilst not changed from that of extant ISA 600) could initially be misleading because in some jurisdictions, the term “group financial statements” will not necessarily include financial statements of a single entity; even one that organizes its financial reporting process using “separate” branches or units. The explanation in para. A17 clarifies the application concept well. We therefore suggest this material might be made more prominent. As a minimum, adding “within a single reporting entity” or similar would also make para. 11(b) clearer.

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?

As far as SMPs - who in many jurisdictions will serve as component auditors on the largest group audits or as group auditor for smaller or medium sized groups – are concerned, the proposed standard appears sufficiently scalable. However, there may still need to be firmer requirements for an audit approach relating to the involvement of component auditors. Leaving the decision on work to be performed and by whom entirely to the discretion of the GET carries a danger that a group auditor may erroneously elect to perform all risk identification, assessment and responsive procedures without recourse to component auditors, which could be detrimental to audit quality of the group financial statements. The component auditor may have specific in-depth knowledge and

expertise, which the GET will not be privy to without their involvement. This could result in some risks of material misstatement being missed as the GET may not be able to make fully informed judgments. As explained in response to question. 2 above, the SMPAG urges the Board to develop a mechanism to ensure audit quality will not be compromised by potentially less-well-informed decisions as to the involvement of component auditors.

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?

Yes. Whilst we believe that the auditor will often use the entity’s organizational and reporting structure in determining components in a group audit, we support the flexibility for the auditor to choose a different way for categorization, where this is possibly more effective. Nevertheless, there is a concern about there being potential difficulties with some regulators with the focus on the ‘auditor view’.

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?

With one exception, we believe that ED-600 appropriately addresses this issue. In regard to material investment accounted for on an equity basis, we believe that the auditor would need to do more work than merely consider published financial statements (see para. A29)

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?

We have different views on this area, stemming from different perceptions of the diverse circumstances of group audit constructs and different legal environments. ED ISA 600 proposes a top-down approach that will work well in many group audit circumstances – especially where the entire group is within a single jurisdiction, but it may be less appropriate for larger geographically spread groups.

Some practitioners believe that the proposed removal of the requirement for an audit for significant components and allowing the GET to elect to perform all risk identification, assessment and responsive procedures without recourse to component auditors could be detrimental to audit quality of the group financial statements, especially in respect of larger geographically spread groups. In addition, in certain cases it could be more efficient for the component auditor to perform the risk assessment and design procedures to address the risks, and then have those reviewed and approved by the GET. Indeed, .e. in some circumstances, it might become more efficient and effective to audit the financial information of the component in its entirety, rather than have the GET designing and performing further audit procedures, which may not cover all of a specific component’s financial information, potentially impacting the quality of the group audit engagement. -especially where the component is “significant” in terms of extant ISA 600.

Other practitioners are very supportive of the enhanced risk-based approach. They believe that this is in alignment with ISA 315 (Revised), especially with the removal of identifying significant and non-significant components. They are supportive of the fact that the risk assessment should be driving the work effort for the audit, rather than how significant the component is as in the extant. The SMP

AG agrees that the proposed top-down approach should be appropriate in many group situations possibly other than in respect of larger geographically spread groups.

In addition, some have observed that there can currently be an inconsistent approach to the audit of components by group auditors, even when the component is relatively large as part of a group. In practice the use of the term “significant component” can be poorly understood and inconsistently used. While there are some suggestions in extant ISA 600 as to how this may be defined (for example 15% of a chosen benchmark), it is still for the GET to decide what benchmark or percentage is appropriate.

In conclusion, and as explained in response to question 2 above, the SMPAG urges the Board to develop a mechanism to ensure audit quality will not be compromised by potentially less-well-informed decisions as to the involvement of component auditors.

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 standard is generally clear as to the respective responsibilities and clearly portrays the “add-ons” for the GET where component auditors are involved, but – as explained elsewhere – we are concerned about the potential for the exclusion of component auditors.

Whilst we note that ED-600 deals with the situation where a group engagement partner may be forced not to use component auditors (para. 22), we remain concerned that there are no requirements (or helpful guidance material) to ensure component auditors are used in group audit circumstances where – so as not to potentially compromise audit quality – it would be necessary to do so. The focus of application material seems more on difficulties for the group engagement partner and GET that using component auditors may bring (para. A48 – A52). The fact that component auditors from outside the firm or in some cases network cannot be subjected to the same incentives and disincentives as those within the same firm as the group engagement partner is, however, not addressed. From our perspective this is a further reason why some previous component auditors may face “discrimination” when the composition of engagement teams for group audits are being planned.

(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 agree that that the GET and group engagement partner respectively must be sufficiently involved in the group audit and that the group engagement partner must take responsibility for the engagement overall. However, as discussed elsewhere, we are concerned at the potential for a GET to elect for the non-involvement of component auditors, especially in cases where the involvement of the component auditors would have been warranted.

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

The main concern raised is that in some cases, the GET may believe it has sufficient information and resources to perform a group audit in an effective manner without involving component auditors when this is actually not the case, such that audit quality is compromised.

Through this new approach, the work effort on a significant component may potentially be inadequate, insufficiently effective, or even mis-directed if based on inadequately informed risk identification and

assessment. It is, however, unclear if such a change in work effort compared with that under extant ISA 600 will be able to satisfy audit regulators' increasingly demanding expectations.

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

There is potentially a risk that controls that are designed to be common are applied differently in practice in different components. This would exacerbate the problem we note in response to question 8 (c) above.

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?

Component performance materiality (CPM) is an important element of a risk-based audit approach. The SMPAG is of the view that the application material that has been included on aggregation risk and factors to consider in determining CPM is generally adequate.

As outlined above, there are some practitioners who believe that there is a potential issue resulting from the proposed deletion of the requirement in extant ISA 600 for an audit in respect of the financial information of a significant component. Without an appropriate replacement mechanism for the performance materiality at a significant component, they have suggested the risk of material misstatement at group level may not be adequately addressed, particularly when the GET might lack some of the necessary information to be sufficiently familiar with the significant component's risk profile.

Nevertheless, in other cases practitioners support the revised approach and believe that it will build consistency in considerations for determining CPM, although there are calls for the Board to provide more practical examples on how CPM is calculated within a complex group structure and its correlation with group performance materiality used by the GET that will address the group's aggregation risk during the consolidation process. This could be in the form of a separate staff publication.

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 have not identified any such matters.

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?

Some of the application material (e.g. A124) in relation to documentation suggests that the GET is required to include component auditor's documentation, in whole or in part, in the documentation of the GET when there are access difficulties across borders. This appears to be driven by audit regulators, who wish to be able to access all of the documentation of the group audit at the premises of the GET. When there are access difficulties, it means that members of the engagement team may need to visit the premises of the component auditor, but in our view, they should be required to document only the nature, timing and extent of their review of the work of the component auditor (which may involve a high-level summary of the work performed by the component auditor) – not the details of the procedures performed. If

audit regulators want to seek access to greater detail beyond the documentation of the direction, supervision and review of the GET of the component auditor's work, then they should seek to visit the premises of the component auditor, and if necessary, liaise with local audit regulator.

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

We have not identified further issues beyond those explained above.

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 comments

- 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.**

Once ED-600 has been approved, due process for translation alone would be expected to take about six months. Adopting the translation with additions for national legal issues (if any) may take up to another six months. Once the standard is adopted, we expect firms to need up to six months to change their methodologies (or adopt their institutes' guidance, which may also take up to six months to develop) and another few months to train all of their staff to use the new standard. For these reasons, a 24-month period after approval would be appropriate for an effective date.

ADDITIONAL COMMENTS

Use of Group Engagement Team and Engagement Team Definition

The use of "group engagement team" or GET and "engagement team" to mean two different constructs is likely to lead to considerable confusion. The opening sentence of para. 15 provides a good example, using both in one sentence, where grammatically it would not be essential to repeat the adjective "group". We believe that GET definition could be replaced by a clearer term e.g., "lead team" or similar, to clearly differentiated the function of this subset of the engagement team.

Using Audit Evidence from an Audit Performed for Another Purpose

We also have concern with the standard with regard to paragraph 42 that deals with using audit evidence from an audit performed for another purpose. Some stakeholders believe the standard is unclear about when it would be appropriate to use audit evidence from these audits for the purpose of the group audit. For example, regarding para.42(a), how would the GET evaluate that the audit procedures performed in the statutory audit are an appropriate response to the assessed risks of material misstatement of the group financial statements? We believe this paragraph requires further analysis and understanding of the issues involved in using audit evidence from these audits.

Ethical Requirements

It is understandable that if the component auditors are performing work within the group audit, it would be expected that they comply with the same ethical requirements as other engagement team members (or at least within the GET). However, there are concerns that compliance with para. 20 will be a real practical challenge and lead to extensive administration and cost. There are also calls for ISA 600 to provide additional application material on assessing the component auditor's independence and ethical compliance when he/she is subject to a different regulatory regime than the group audit firm.

Para. A37 prescribes "in communicating relevant ethical requirements, the GET may consider whether additional information or training for component auditors is necessary with respect to the provisions of the ethical requirements that are relevant to the group audit engagement". We would like to question the practicality of providing training for the component auditors in this respect.

Communication about the Restrictions on Access to Information/ People

According to para. A30 of the ED, when the GET cannot overcome restrictions on access to information/people, the GET may communicate about the restrictions to the firm, regulators, listing authorities, or others. However, the term "others" can be too ambiguous and overly broad for the group auditor to determine who "others" would be, particularly for group audits not involving listing authorities or industrial regulators. We would like to seek clarification in this regard, e.g. whether "others" would be confined to appropriate stakeholders required by laws, regulations and/ or contracts.

Cooperation of the Component Auditors with the GET

In practice, getting the component auditors to cooperate with the GET can also be an issue. Is it possible to include in the ISA some statement on the importance of the component auditors cooperating with the GET to facilitate the review of working papers of the component, where applicable? There have been requests in the past for the GET to pre-sign a "hold harmless" letter before working papers of the component auditors can be accessed.

Public Interest

ED-600 placed a particular focus on public interest issues. However, certain jurisdictions may consider such relevant requirements to be too onerous in case of non-PIE entities group audits, whose applicable "interest" could merely be stakeholders' interests rather than the broader public interest.

CONCLUDING COMMENTS

We hope that the IAASB will find this letter useful. We are committed to helping the Board in whatever way we can to build upon the results of this very important ED.

Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,



Monica Foerster

Chair, SMP Advisory Group