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11 September 2020

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, NY 10017 U.S.A.

Our Ref: 2020/O/C1/IAASB/MS/84

Subject Line: IAASB's Exposure Draft: *Proposed ISA 600 (Revised), Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Dear Sir:

The International Organization of Securities Commissions' Committee on Issuer Accounting, Audit and Disclosure (Committee 1) appreciates the opportunity to comment on the International Auditing and Assurance Standards Board's (the IAASB or the Board) Exposure Draft: *Proposed ISA 600 (Revised), Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (the Paper). As an international organization of securities regulators representing the public interest, IOSCO is committed to enhancing the integrity of international markets through the promotion of high quality accounting, auditing and professional standards, and other pronouncements and statements.

Members of Committee 1 seek to further IOSCO's mission through thoughtful consideration of accounting, disclosure and auditing concerns, and pursuit of improved global financial reporting. Unless otherwise noted, the comments we have provided herein reflect a general consensus among the members of Committee 1 and are not intended to include all of the comments that might be provided by individual securities regulator members on behalf of their respective jurisdictions.



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Overall Comments

The expanding global, multi-location reach of companies, together with changing business models, suggest that the audits of group financial statements will continue to be a common assurance service. As such, we support the Board's efforts to revise and enhance ISA 600, *Special Considerations – Audits of Group Financial Statements (including the work of Component Auditors)*, as a matter of priority.

Additionally, we appreciate the Paper's explicit emphasis on the fact that the group engagement partner is ultimately responsible, and therefore accountable, for managing and achieving quality on a group audit, including compliance with ISA 600 (Revised) as well as all other ISA requirements. We also appreciate the Paper's focus on the direction, supervision and review of the work of the component auditor by the group engagement partner and the group engagement team, which we believe is an improvement from extant ISA 600. Having said this, we encourage the Board to emphasize in the final standard that the group engagement partner cannot be absolved from or otherwise delegate his/her responsibility for the planning and execution of the group audit.

However, in addition to the explicit requirements for the group engagement partner and group engagement team, we believe the Paper should be more robust in also articulating the requirements and responsibilities of component auditors throughout the various stages of the group audit. Some examples of potential requirements for component auditors are further discussed below, under "Preliminary Risk Assessment Process of the Component", "Fraud Risk" and "Documentation and Access Restrictions"

Applicability of Other Relevant ISAs

Paragraph 1 of the Paper states that:

"The International Standards on Auditing (ISAs) apply to an audit of group financial statements. This ISA deals with special considerations that apply to an audit of group financial statements, including in those circumstances when component auditors are involved. 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 (a group audit), in particular proposed ISA 220 (Revised), ISA 315 (Revised 2019), and ISA 330.3 (Ref: Para. A1–A2)."



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We agree with the Board's approach to emphasize that all ISAs apply to group audits and to include all incremental requirements relevant to group audit engagements within ISA 600 (revised) as this results in specific incremental requirements and application material from a group audit perspective being presented in one location.

Having said that, we believe the applicability of other ISAs to group audits would be clarified and strengthened if the first sentence of that paragraph is rephrased to state "In an audit of group financial statements, all other ISAs must be considered and, where applicable, applied, in addition to this ISA."

Further, if the Board continues to list particular ISAs that are relevant, it may be worthwhile to also include ISA 260, *Communication with Those Charged with Governance*, and ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*, both of which may have differing implications in group structures.

The Auditor View of Business Units and Entities

Paragraph 3 of the Paper states that:

"The group engagement team may plan and perform an audit of group financial statements based on the entities or business units as viewed by group management. Alternatively, the group engagement team may determine that it is effective and more efficient to obtain audit evidence by planning and performing the group audit based on locations, functions or activities that are not necessarily aligned with how group management views the entities or business units comprising the group."

We believe the Board should emphasize within paragraph 3, the need for the auditor to first understand management's view of the business prior to selecting an alternative approach to identifying components. Though this may seem to be a departure from the auditor's traditional audit approach as required by other ISAs addressing areas such as understanding of the entity, risk assessment, control determination and testing, etc., we believe it can assist the auditor in gaining a better understanding of the entity by leveraging management's understanding of its business and ultimately result in a better determination of components.

Once the auditor attains an understanding of group management's view of the business, it may be necessary to consider additional factors, beyond how management runs the business,



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to better determine components. Such factors may include locations, functions or activities, as identified by the Board in the Paper in the proposed definition of “component”, that are not necessarily aligned with how group management views its business. However, other factors may also be relevant in the determination of components, for example, whether a risk of material misstatement due to fraud may exist, or interdependency between locations (i.e. when a single class of transactions is processed through multiple locations).

In addition, we are of the view that certain processes of the group, if present, are best assessed above and beyond the evaluation of business components. Examples of these processes are outlined below:

Consolidation Process

Due to the potential risk of fraud associated with the consolidation process, we believe the Board should include this as a separate consideration beyond the assessment of business components.

Matrix Organization Structure

Where management uses a complex structure to operate the business (for example, a matrix structure in which management simultaneously operates the business using two co-existing structures such as by product line as well as by geography—see IFRS 8, *Operating Segments*, paragraph 10), the group auditor should factor this level of complexity into its planning. The entity structure should be specifically addressed by the Board as it finalizes the standard.

Shared Service Center Considerations

Paragraph A6 states that “A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example, through the use of a shared service center. When such centralized activities are relevant to the group’s financial reporting process and audit procedures are performed at that location, the group engagement team may determine that the shared service center is a component for purposes of the group audit.”

We believe shared service centers should be viewed and assessed separately from business components in planning the group audit as the volume of transactions and the services



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provided can often be above and beyond traditional components as identified based on line of service or geography.

Application to Combined Financial Statements

Paragraph 11 states that “Reference in this ISA to “consolidation process” includes the recognition, measurement, presentation, and disclosure, in accordance with the requirements of the applicable financial reporting framework, of financial information of entities or business units in the group financial statements by way of:

- (a) Consolidation, proportionate consolidation, or the equity methods of accounting;
- (b) The aggregation of the financial information of branches or divisions; or
- (c) The presentation in *combined financial statements* of the financial information of entities or business units *that have no parent but are under common control*. (emphasis added).

While the inclusion of combined financial statements of entities or business units that have no parent but are under common control is appropriate, we believe an applicable financial reporting framework could permit the use of combined financial statements in other circumstances, e.g., when there is common management but not common control. We encourage the Board to consider expanding the application of the consolidated process to all types of combined financial statements that are permitted under the applicable financial reporting framework.

Definition of Component

Paragraph 9(b) defines a component as:

“Component – a location, function or activity (or combination of locations, functions or activities) determined by the group engagement team for purposes of planning and performing audit procedures in a group audit”.

Relatedly, paragraph A12 states that:

“Component: As noted in paragraph A4, the group engagement team uses professional judgment in determining the components for which audit procedures will be performed. Although the group engagement team may combine certain entities or business units for purposes of planning and performing the group audit, the group engagement team’s



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Organización Internacional de Comisiones de Valores

consideration of the risks of material misstatement of the group financial statements encompasses all of the entities and business units that comprise the group. In other words, the group engagement team's view of components for the group audit and how entities or business units may be combined to facilitate the performance of the group audit considers all of the entities and business units that are included in the consolidation process."

We believe the definition of component is too vague and inconclusive to drive consistent application of the standard by auditors. We believe that the definition and subsequent application by auditors would be enhanced if the Board were to first describe components of the business (we use the term "business component" for ease of reference) and then supplement that description with other process-oriented components (such as consolidation process or shared-service centers). While we agree that the group engagement team should use professional judgment in determining components, we also see the need for the Board to provide factors for consideration to assist auditors in identifying components.

In addition, we encourage the Board to set clear expectations of whether some audit procedures need to be performed on all components. If no audit procedures are to be performed at certain components (because no risk of material misstatement of the group financial statements is identified individually and in aggregate at these components), the Board should provide guidance for the group engagement team to consider when evaluating aggregation risk – see further discussion on aggregation risk below.

Finally, we wanted to highlight a potential inconsistency in the definition of engagement team particularly considering an external expert and/or an external service provider. Paragraph A13 states, "The engagement team includes individuals from the group engagement team's firm and may *include* individuals from a network firm, a firm that is not a network firm, *or an external service provider*". (emphasis added). However, the definition of engagement team in ISA 220 (Revised) paragraph 10(d) in the February 2019 Exposure Draft states, "The engagement team *excludes an auditor's external expert* engaged by the firm or a network firm". (emphasis added). As such, it appears that under ISA 220 (Revised), an external expert engaged as a service provider would be excluded from the definition of engagement team, whereas, this same expert would be included in the definition of engagement team under ISA 600 (Revised). We encourage the Board to align the definitions between the two standards.



International Organization of Securities Commissions
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Furthermore, because of differing effective dates of the standards, even when the Board aligns the related engagement team definitions there may be a period of time when the definitions differ. As such, we encourage the Board to consider the potential implications for group auditors if ISA 600 (Revised) and ISA 220 (Revised) have different effective dates.

Preliminary Risk Assessment Process of the Component

We agree with paragraph 31 that states:

“In applying ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*, based on the understanding obtained in paragraph 24, the group engagement team shall take responsibility for the identification and the assessment of the risks of material misstatement of the group financial statements.”

We agree that it is appropriate for the group engagement team to take responsibility for the risk assessment with respect to the group financial statements taken as a whole. However, it is still unclear how the component auditor’s assessment of risk at the component level is expected to affect the group engagement team’s assessment (or vice versa). For example, should the group auditor be providing its group level risk assessment to the component auditor to assist in determining the extent of risk and procedures to be performed at the component level (or is it vice versa, or continuous, etc.)?

In addition, we note that paragraph 9(a) defines aggregation risk as:

“Aggregation risk – The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.”

Relatedly, paragraph A11 states that:

“Aggregation risk exists in all audits of financial statements, but is particularly important to understand and address in a group audit engagement because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances or disclosures that are disaggregated across components.”

While we appreciate the definition, we believe the broader concept that “aggregation risk increases as the number of components increases at which audit procedures are performed



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Organización Internacional de Comisiones de Valores

separately, either by component auditors or other members of the engagement team”, as discussed in Explanatory Memorandum paragraph 80, should be explicit in the standard or application material. This will further strengthen the auditor’s consideration of aggregation risk in a group audit. Furthermore, to the extent that audit procedures are not performed at certain components, the group auditor should be reminded to consider the aggregation risk that exists within these components as part of its overall assessment of aggregation risk and its ultimate determination of whether it has obtained sufficient appropriate audit evidence to support the group audit opinion.

It would be useful for the Board to provide additional guidance in the areas above to set clear expectations and direct the work effort of both the group engagement team and the component auditor.

Separately, we note that the Board recently completed ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*. While we generally agree with the Board that the requirements and application materials in the Paper are consistent with the revisions in ISA 315 (Revised 2019), we are concerned that the removal of the concept of “significant component” might have unintended consequences, including challenges for auditors to consistently apply the standard, potentially reducing the work performed by auditors thus potentially reducing audit quality in a group audit.

To compound our concern, we observe that there is no guidance for the minimum work effort required to be performed on components. We believe the retention of the concept of “significant component” with enhanced procedures around the risk of material misstatement, enhanced communication requirements from component auditor to group auditor (as well as component to component communication, where appropriate) would be a more effective approach in driving auditors to perform sufficient audit procedures.

We encourage the Board to consider updating a closely related standard, ISA 330, *the Auditor’s Responses to Assessed Risks*. The Board should consider updating this standard more holistically when it develops its Work Plan for 2022 – 2023 so that ISA 330 can better reflect the risk-based approach other recently updated ISAs have incorporated.

Performance Materiality

Paragraph 29 states that:



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Organización Internacional de Comisiones de Valores

“In applying ISA 320 and ISA 450 when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, the group engagement team shall determine:

(a) Component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality. (Ref: Para. A73–A76)

(b) The threshold above which misstatements identified in component financial information are to be communicated to the group engagement team. Such threshold shall not exceed the amount regarded as clearly trivial to the group financial statements.” [footnotes omitted]

We believe paragraph 29 and the related application material did not go far enough to assist the auditor in determining how the group materiality under ISA 320 for the group financial statements, as a whole, is intended to flow through to the determination of component materiality. While the factors in paragraph A75 are helpful, further guidance is needed in this area which can be particularly challenging in a group audit. Currently, the Paper is too broad and subjective which could make it challenging for auditors to consistently and appropriately establish component performance materiality.

In addition, paragraph A73 states that:

“the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality”.

We find it challenging to understand how auditors will consistently assess whether the aggregation of component performance materiality exceeding group performance materiality is appropriate, as well as adequately assess whether the relationship between component performance materiality for a specific component and group overall materiality is appropriate. We believe additional guidance, including quantitative considerations, need to be included in the Paper to address component performance materiality and its effect on the materiality of the group audit.



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In addition, with regard to the “stand back” requirement included in paragraph 49-51 (and as also mentioned in paragraph 97 of the Explanatory Memorandum), we believe the group engagement team should be required to assess whether the aggregation risk of the group audit is at an acceptable level considering all the audit evidence evaluated. Consistent with our comments above on aggregation risk under the section “Preliminary Risk Assessment Process of the Component”, we believe aggregation risk is particularly important in a group audit and warrants further attention when the group engagement team performs a “stand back” evaluation as required in paragraph 49. As a result, we believe it would be appropriate to include additional guidance for the group engagement team to assess aggregation risk over significant classes of transactions, account balances or disclosures in the group financial statements as part of the “stand back” analysis.

In this regard, we encourage the Board to provide more guidance via Application Material on how the group engagement team should assess whether aggregation risk is reduced to an appropriate level. In a group audit, aggregation risk may arise both from the determination of components (for example, no audit procedures are performed at certain components because no risk of material misstatement of the group financial statements is identified individually and in the aggregate at these components), and the determination of component materiality (for example, component materiality may be too high resulting in insufficient audit procedures being performed at the component level). Both of these aspects of aggregation risk can affect the group engagement team’s evaluation of whether sufficient appropriate audit evidence is obtained with respect to the group financial statements, and should be explicitly considered by the group engagement team as part of the “stand back” analysis.

Fraud Risk

We believe that fraud risk assessment procedures at the component level should be strengthened. We believe the Paper could be strengthened by encouraging the group auditor to engage in fraud risk brainstorming sessions that include component audit teams, with the objective of identifying fraud risks at the component level.

While paragraph A80 provides guidance on information used to identify the risks of material misstatement of the group financial statements due to fraud, and the body of the Paper discusses communication when fraud is found, there is little emphasis on developing procedures at the component level to inform the group engagement team’s overall fraud assessment.



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We also note that several frauds have occurred via the consolidation process and the related adjustments. While extant ISA 600 more definitively addresses the consolidation process, we believe the Paper could be strengthened by alerting the group auditor to the heightened possibility for the occurrence of fraud during the consolidation process, and by incorporating additional references to fraud risks in the Paper.

Documentation and Access Restrictions

We appreciate the enhanced documentation requirement in paragraph 57. However, we believe the concept discussed in paragraph A124, where “the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the audit procedures performed, evidenced obtained, and the conclusions reached with respect to significant matters arising during the group audit” is critical and should be explicitly stated within the requirements of the standard. In addition, we believe the Paper needs to require the group auditor to document that it has obtained a sufficient understanding of the components.

Separately, paragraph 57 states that:

“In applying ISA 230, the group engagement team shall include in the audit documentation: (Ref: Para. A124, A129–A130)

- (a) Significant matters related to restrictions on access to people or information that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed.”

While we appreciate the inclusion of a requirement to document significant matters related to restrictions on access to people or information, we believe the requirements and the related Application Material (paragraphs A124, A129–A130) are lacking in sufficient specificity to direct the auditor’s work effort. We encourage the Board to include additional details on what is required. For example, the auditor should be encouraged to request the assistance of the group’s and/or component’s audit committee, where applicable, to obtain the necessary access and/or documentation. Further, where appropriate access is not possible or access issues are outside the control of the auditor, we encourage the Board to emphasize in the Paper the group auditor’s responsibility to evaluate whether sufficient appropriate audit



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evidence could be obtained through alternative audit procedures or if the audit opinion may need to be modified because of a limitation of scope to minimize the likelihood of an unnecessary delay in finalizing the audit report.

In addition, the Paper references ISA 230, *Audit Documentation*, which requires that the audit file provide documentation that the audit was planned and performed in accordance with the standards and other legal and regulatory requirements. We question whether reference to ISA 230 is sufficient. Perhaps in addition to references to ISA 230, an explicit requirement within the Paper regarding group audit documentation would be more effective.

Further, we believe certain requirements suggest that in some circumstances, communication is required only if there is an issue identified by the component auditor (e.g., paragraph 44(d)). We encourage the Board to include documentation requirements for each item listed in paragraph 44 so that there is no confusion. For example, 44(d) would require the component auditor to state explicitly whether they have, or have not, identified any management bias, and if there is potential bias, to provide further explanation.

Relatedly, we note that paragraph 44 of the Paper references the component auditor's communication with the group engagement team regarding information on instances of non-compliance with laws or regulations. However, the scope of the requirement is unclear. Does the requirement refer to the component's compliance or solely to group management's compliance or both? Further, what is the threshold for the group engagement team documenting non-compliance matters? In addition, should trivial matters be documented, or to whom does the applicable Code of Ethics apply?

Communications from Component Auditors and the Use of Opinions, Including in Letterbox Audits Situations

While we understand that in practice the auditor generally provides a deliverable based on the nature of the engagement, we believe the current construct of paragraph 44 (h) of the Paper may be confusing with respect to whether all three deliverables (findings, conclusions and opinions) are required to be provided by the component auditor for one engagement.

Paragraph 44 (h) states that: "The group engagement team shall request the component auditor to communicate matters relevant to the group engagement team's conclusion with regard to the group audit. Such communication shall include:



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(h) The component auditor's overall findings, conclusions or opinion.”

We believe practice issues have arisen, in part, as a result of the standard allowing component auditors to provide findings, conclusions or opinions without defining these terms. What does it mean for an auditor to provide each of these, and when is the use of each appropriate? The Board should review and provide guidance in the Application Material on how the terms “findings”, “conclusions”, as well as “opinions” or the memos used to communicate these outputs, are meant to be applied based upon the type of engagement the group auditor directs the component auditor to perform, and also clarify which of the related deliverables expected of the component auditor.

Additionally, we are concerned where the component auditor only provides an “opinion” or a memo on their work to the group engagement partner. We believe this could encourage the group engagement partner to place undue reliance upon such an opinion or memo for purposes of the group audit without obtaining sufficient appropriate audit evidence regarding the financial information and other typical areas of audit findings (e.g., function of internal controls, passed financial statement adjustments, and potential auditor independence issues) of the components and having performed appropriate review of the component auditor's workpapers.

In addition, the use of an opinion by the component auditor seems inconsistent with (1) the fact that the component auditor is a member of the group engagement team and (2) the general intent of the Paper that portrays the work of the component auditor as a collection of specified procedures. We believe the component auditor should provide a report of its findings or the results of applying procedures. These reports or results could then be used by the group engagement partner (along with audit evidence from all the other audit work performed) to develop an opinion on the group financial statements as a whole.

We believe the Board should further consider what the impact is on audit quality if a component auditor only provides opinions to the group engagement team consistent with paragraph 44(h) of the Paper. For example, with respect to opinions, as highlighted in our concerns above, the group engagement team should not consider an “opinion” to be the only audit evidence that eliminates the need for the group engagement team to be sufficiently involved with the work of the component auditor and to obtain sufficient appropriate audit evidence regarding the financial information of the components. We believe the Board should



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consider whether or not receipt of an opinion may give rise to unintended consequences with respect to the component and group auditor. If opinions are retained in the Paper, then it should be emphasized in the requirements that the group auditor cannot rely on the opinion provided by the component auditor as the sole form of audit evidence over that component. Where an opinion is the only form of communication due to documentation restrictions, please refer to our comments under the section entitled “Documentation and Access Restrictions” above.

Relatedly, we are of the view that the Paper does not fully convey or discuss in sufficient detail the unique challenges that can exist where the engagement partner is not located in the jurisdiction where the majority of the audit work is performed (referred to by some as audits of letterbox companies). We believe the Paper should clearly state whether it covers letterbox audits or not, and if it does, how this guidance applies to the group auditor.

Thank you for the opportunity to comment on the Paper. If you have any questions or would like to further discuss these matters, please contact Michael Porth at ph. + 49[0]228 4108-4013 (email: michael.porth@bafin.de) or myself. In case of any written correspondence, please mark a copy to me.

Sincerely,

Makoto Sonoda
Chair, Committee on Issuer Accounting, Audit and Disclosure
International Organization of Securities Commissions