

September 8, 2020

Mr. Thomas R. Seidenstein (Chair)  
International Auditing and Assurance Standards Board (IAASB)  
Submitted electronically

**Subject: Comments on the IAASB proposed revisions to International Standard on Auditing 600: Special Considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)**

The Canadian Public Accountability Board (CPAB) is pleased to respond to the exposure draft International Standard on Auditing 600 (revised): Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors) and Proposed Conforming and Consequential Amendments to Other ISAs (ED-600).

We were impressed by the scope and depth of the IAASB’s efforts to re-examine its standards over the audits of group financial statements, including the interrelationship with the quality control standards. We fully agree that audit firms must do more to embed audit quality on a consistent basis, and this exposure draft significantly improves on the extant ISA 600. CPAB has reviewed the exposure draft and shared comments with other regulators through the International Forum of Independent Audit Regulators (IFIAR).

**Overall comments**

We support the direction of the standard to clarify the linkages with other standards and address special considerations in an audit of group financial statements. We further support the structure of ED-600 with the inclusion of subsections throughout the standard that highlight the requirements when a component auditor is involved.

There are areas where either the linkages to other standards could be strengthened or further requirements and/or application guidance is necessary to improve the special considerations in the audit of group financial statements to drive consistent application of ED-600, while taking into consideration specific facts and circumstances, as described below.

The release of ED-600 is long overdue. The nature and frequency of scandals involving foreign components causes significant risk to the global investing public. To allow time for implementation by audit firms, we recommend that there are no unnecessary delays to the effective date of this standard. The earliest effective date of ED-600 is for audits of group financial statements for periods beginning on or after December 15, 2022, which is aligned with

the anticipated effective dates for the revised quality management standards, ISA 220 *Quality control for an audit of financial statements*, International Standards on Quality Management (ISQM) 1 and ISQM 2. We strongly recommend the IAASB aim to finalize this proposed standard no later than June 2021 to support this implementation date.

### **Scope and applicability**

We acknowledge that an auditor's view of the entities and business units comprising the group for the purpose of planning and performing the group audit may provide more flexibility and potentially assist with the scalability of the standard. This may increase the level of complexity in practice for auditors and could also increase the risk of inappropriate application. There is an increased risk of inappropriate scoping to achieve efficiencies in the audit at the cost of quality. For example, there is a risk that the group auditor may group entities and treat them as a homogeneous population when it is not appropriate and/or inconsistent with the facts and circumstances of the entities.

We recommend the IAASB consider including additional application material on scoping to assist auditors. It should also emphasize the requirement for the group engagement team to evidence their judgments where the auditor's view of the components differs from management's and its consequential impact on the risk assessment, testing of internal controls and substantive testing.

### **Risk assessment**

We support the direction of the standard and the stronger linkage to the requirements of ISA 315 *Identifying and assessing risks of material misstatement* and ISA 330 *The auditor's responses to assessed risks*. The IAASB could further enhance ED-600 in a few key areas:

- The application material A 97 proposes three approaches to assigning further audit procedures when the group engagement team uses a component auditor. There is limited guidance to determine when these approaches would apply. Additional guidance could better support the group engagement team's decisions when assigning responsibility for the design of further audit procedures to the component auditor including for example, providing better linkage between A 97 and A 98 to A 101.
- As part of the assessment of risks at the group financial statement level, the group engagement team should, where a component auditor is involved, request the component auditor provide input to the relevant risk assessments at the component level for the group audit in order to benefit from their knowledge of the component and its environment.

## **Materiality and aggregation risk**

We support the direction of the new component performance materiality definition in paragraph 9(e) of ED-600 which indicates that it must be set to reduce aggregation risk to an appropriately low level. Additional qualitative considerations are necessary to assist auditors in determining how component performance materiality should be determined while considering aggregation risk and whether the initial performance materiality continues to be appropriate. Examples of such considerations include but should not be limited to the existence of statutory or regulatory reporting requirements, potential effect on loan provisions, debt covenants, contractual arrangements, implication for fraud/illegal acts, etc.

Paragraph A 73 indicates that a different component materiality may be established for each component where audit procedures are performed. This should be more explicit as a requirement that a separate component materiality must be determined based on the specific characteristics, facts, and nature of the accounts at each component.

## **Consideration of fraud in the audit of group financial statements**

Further guidance over and above paragraphs 34 and 35 should be included given the importance of the consolidation process to the group financial statements. Frauds can be perpetrated via consolidation and other adjustments. Therefore, we recommend including additional references to risks of material misstatement due to fraud, including increased susceptibility to fraud in relation to the consolidation process.

In addition, the guidance in A 80 that the auditor or group engagement partner may consider whether there are components for which the risks of material misstatement due to fraud is higher should be a requirement.

## **Communication**

To reinforce two-way communication between the group engagement team and component auditors and the group engagement team's direction and supervision of component auditors, we encourage the IAASB to add the following items to the requirements listed in paragraph 44 of ED-600:

- A 116 states that a group engagement partner may consider whether misstatements communicated by component auditors indicate a systematic issue. There should also be a requirement for the group engagement team to request for the component auditor to communicate adjusted items. This may assist the group engagement team to perform the 'stand-back' requirement, including understanding whether there are any pervasive issues in the group which could indicate similar uncorrected misstatements in other components or controls that are not operating effectively that could impact initial risk assessments.

- There is no explicit requirement for the component auditor to communicate matters and/or accounts balances where the component auditor made different significant judgments from those communicated by the group engagement team to the component auditors, including the nature of those judgements made by the component auditor. This should be included as a required communication by the component auditor to the group engagement team as it will assist the group engagement team in its application of ISA 701 *Communicating key audit matters in the independent auditor's report* at the group level, where applicable.

### **Component auditor oversight**

There is limited guidance on when a group auditor is expected to visit a component auditor or when the group engagement team should review the component auditor's audit working papers. It is unclear how the risk-based approach used to determine the work efforts of the component auditor could translate into the actual procedures expected to be performed by the group engagement team and/or component auditor. ED-600 proposes that the higher the auditor's assessment of risk, the more persuasive audit evidence needs to be obtained and more involvement of the group engagement team would be expected. The requirements in paragraph 32 should include additional requirements or application material on actions the group engagement team can take as the risk associated with a component increases due to significance or risks assessed at the higher end of the risk spectrum, combined with the knowledge, skill and ability of the component auditor.

ED-600 leaves too much flexibility for the group engagement team to conclude that it is not necessary to visit or review the working papers of the component auditor where the component auditor is part of the same network of firms. 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". These provisions, associated with the application material (A 113), are insufficient to determine the level of review needed and should be strengthened by including a requirement for the group engagement partner to evidence their oversight as defined by ISA 230, *Audit documentation* (ISA 230) paragraph 8-11 and revised ISA 220, *Quality control for an audit of financial statements* (ISA 220) paragraph 17 (A 17 to A 18).

In many cases auditors and companies attempt to use component auditors from the same network as the group auditor. ED-600 appears to indicate that the work effort required to review the component auditor's work would be reduced if that auditor is from the same network (A 46). The standard should be neutral in this regard and the amount of work effort should depend on the specific facts and circumstances of the group audit engagement and the firm, as described further below under quality management standards.

## **Restrictions on access to information and people**

ED-600 includes details on how to address and/or overcome restrictions on the group engagement team's access to information and people at different stages of the audit process. Specifically, A 30 refers to the group engagement team's communication with the group engagement team's firm, who in turn may communicate the restrictions with regulators, listing authorities or others and may encourage group management to communicate with regulators. It is not clear what the objective or purpose of such communication is or how it helps overcome the concerns arising from the access to information and/or people. While we support the direction of the proposed revisions, additional guidance is needed to understand and demonstrate how aspects of access restrictions could be overcome.

## **Documentation requirements**

The requirements of paragraph 57 and the related application material in A 126 to A 130 of ED-600 include clear linkages to ISA 230. These demonstrate the requirement of what is expected by the group engagement team. However, we recommend including additional application guidance related to the level of detail expected to support the group engagement team review of the component auditor working papers. The group engagement team should be required to demonstrate the extent of oversight, and how the group engagement team reached their conclusions regarding the sufficiency and appropriateness of the nature and extent of procedures performed by the component auditors.

## **Quality management standards**

Additional application guidance is necessary to understand the interrelationship between ED-600 and ISQM 1, ISQM 2 with respect to the responsibilities of the group engagement team and reliance on the firm's system of internal controls. Specifically:

- A 20 in ED-600 discusses common policies and procedures established by the firm that are common and may support the group engagement partner by facilitating communication between the group engagement team and component auditors. We suggest clarifying to better understand the link between the policies and procedures of the firm or common network requirements or network service and how the group engagement team may use this information for communications. It is also unclear how the automated tools or techniques discussed in A 5 are different from those discussed in A 20.
- There should be a stronger linkage to ISQM 1 in A 42 to A 44 regarding the competence and capabilities of the component auditors.
- A 39 of ED-600 should be enhanced to reinforce the group engagement team's and component auditor's responsibility over compliance with the relevant ethical requirements, including those related to independence. Specifically, threats to independence may arise in group audits with multiple components with respect to the allocation of fees and other remuneration arrangements. Further, personal financial

investments or other financial arrangements made by component auditors in the consolidated entity are a clear independence issue and should be prohibited. We recognize that independence and ethical standards are handled by separate standard setting bodies, but it is critical that those charged with governance and the users of the audit report are aware of the existence of any such situation. We recommend including additional guidance with a clear link to paragraph 17 of ISA 260, *Communication with those charged with governance* to support the independence requirements.

### **Implementation guidance**

The IAASB should consider how to address instances that may arise in the first year of implementation where the group engagement team and the firm rely on policies and procedures at a network firm that have been implemented but responses not yet evaluated. We recommend including guidance and/or application material in conjunction with ISQM 1, including any relevant responses and policies that the group engagement team relied on.

Please do not hesitate to contact me or Stacy Hammett, Senior Director, Inspections to discuss any of our comments.

Yours truly,



Carol A. Paradine, CPA, CA  
Chief Executive Officer

cc: Ken Charbonneau, Chair of the AASB