Proposed Part 10, Audits of Group Financial Statements of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE)

RESPONSE:

Name of Respondent:	**Jamie Drummond/Gillian Morrison**
Organization (*where relevant*):	**PKF International Limited**
Country/Region/Jurisdiction:	**Global**

Specific Questions

1. In the Authority, do you agree with the proposed prohibition on the use of the proposed ISA for LCE for group audits where component auditors are involved, other than in limited circumstances where physical presence is required?

Response:

We agree with the proposed prohibition on the use of the proposed ISA for LCE for group audits where component auditors are involved, other than in limited circumstances where physical presence is required.

However, we have some concerns regarding the focus and wording of prohibition (ii) and whether this may lead to a risk of inconsistencies in the different scenarios and circumstances in which the standard is used. This may become problematic, during firm inspections, if regulatory bodies question the judgments applied and decisions made by engagement teams when determining whether an engagement is within the scope of the proposed standard, particularly where firms may have stretched the scope beyond what was originally intended.

In an effort to reduce this risk, the IAASB may want to consider promoting the current Qualitative Characteristic on "Access to Info or People" to form the principal part of the Prohibition in A1 (d) (ii). Currently, the specific prohibition in A1 d (ii) has been drafted with the underlying focus being on whether or not component auditors are involved. We would propose to change this focus to consider whether all relevant financial records and client prepared evidence are located in one location (with group management). In our opinion, this point is integral to determine whether the proposed ISA for LCE is suitable for a group audit.

We would propose the following wording:

"The ISA for LCE shall <u>not</u> be used if:

The audit is an audit of group financial statements (group audit) and:

i. Any of the group's individual entities or business units meet the criteria as described in paragraph A1(b) or A1(c); or

ii. (a) Any of the group's information subject to audit procedures cannot be accessed by the group audit team, including for the group's component entities; and

(b) A component auditor is used to perform audit procedures for component entities within the group.

An exception to ii(b) above, is that audit procedures may be performed by a [component auditor / a member of the engagement team based at a remote location] on physical items for which there is no reasonable alternative approach other than to use the [component auditor] for the performance of procedures (e.g., attending a physical inventory count or inspecting physical assets).

2. In the Authority, do you agree with the proposed group-specific qualitative characteristics to describe the scope of group audits for which the proposed ISA for LCE is designed to be used?

Response:

We agree that there should be additional group-specific qualitative characteristics. However, we would propose that the IAASB considers the following matters:

1) "Shall" versus "are to be Considered"

In our opinion, the mixed use of the terms, "shall" and "are to be considered" may lead to inconsistency in application of the qualitative characteristics. For example, A.3 states, "For the purpose of group audits, these considerations shall apply to both the group and each of its individual entities and business units. The "Additional Considerations Relevant for Group Audits" uses the terminology, "are to be considered".

We would suggest that the format for presenting such characteristics should be consistent with the manner in which the qualitative considerations relevant to both individual entities and groups has been presented (i.e. "it would be inappropriate for an audit of the financial statements of the entity to be undertaken using the ISA for LCE if the entity/group exhibits the following…").

2) Group Structure and Activities

The "Group Structure and Activities" suggests that the proposed ISA for LCE would be inappropriate for a group that exhibits more than 5 entities/business units or which operates in more than 3 jurisdictions. In our opinion, the focus on numerical indicators is contrary to the objective of the scope of the proposed ISA for LCE, whereby the focus is on "complexity" rather than "size".

We would propose that the "Qualitative Characteristics" should focus on the complex matters and circumstances within each group entity, their jurisdictions and within the consolidation process, rather than a scope based on how many entities/business units or jurisdictions are within a group.

For example, there may be groups with 6 or more entities across various jurisdictions that have very little activity, are non-complex, low risk and have a simple consolidation process. We would challenge why such a group should be prohibited from the scope of the proposed standard and question whether the focus should rather be directed to whether there are any complex matters or circumstances within the entities or the various jurisdictions and the complexity of the consolidation process.

3) Access to Information or People

As per question 1, we would propose promoting this criteria to be included within the "Specific Prohibitions". Please refer to our comments in question 1, above.

4) Consolidation Process

a) We would suggest including a cross reference to the glossary definition of a consolidation within the proposed ISA for LCE to ensure that users understand the intended scope of the standard.

b) We would suggest that the bullet point on "Intercompany" and "Other Consolidation Adjustments" are divided into 2 separate considerations and examples such as these provided:

- Intercompany adjustments are not complex
  [Indicators of complexity may include cut-off, foreign exchange adjustments, etc.]
- Other consolidation adjustments are not complex
  [Indicators of complexity may include business combinations, foreign exchange, valuation gains and losses, non-controlling interests, etc.]

c) We would like to understand whether the IAASB have determined "non-controlling interests" to be an indicator of complexity within a consolidation process. In our opinion, this is an area where audit differences can often be identified, and we would propose that a group containing a non-controlling interest should be prohibited from the scope of the proposed ISA for LCE.

d) In our experience, management tend to perform and/or finalise consolidations towards the end of the audit engagement and auditors are more likely to identify complex intercompany adjustments towards the end of the audit, despite all attempts to identify these at the early planning phases of the engagement. We are concerned that auditors may find themselves in this predicament and that, at this late stage in the audit, they may be more inclined to 'underplay' the complexity of such a transaction in order to avoid transitioning from the proposed ISA for LCE to full ISA's. We recommend that the IAASB considers how safeguards could be introduced into the final standard to manage such situations effectively.

3. Do you agree with the content of proposed Part 10 and related conforming amendments?

Response:

We agree with the proposed content (and related conforming amendments) but would suggest that the IAASB also considers:

Group Auditor and the Component Auditor Relationship

1) Part 10 does not appear to include any of the specific requirements from ISA 600 regarding the group auditor relationship with the component auditor (e.g., instructions, reporting, review, documentation, etc). We have a concern that this may lead to instances of poor-quality audit procedures being performed by a component auditor due to lack of communication, oversight and/or review by the group auditor.

We would recommend that the IAASB re-evaluates whether the existing requirements in part 3 of the proposed ISA for LCE provide sufficient safeguards over the supervision and review of the component auditor by the engagement partner or whether additional requirements from ISA 600 should be brought into the proposed standard.

Materiality

2) The grey box after paragraph 10.3.1, states that, "*In these circumstances, the auditor may need to consider whether a component performance materiality lower than the* ***amount*** *may be appropriate for those particular classes of transactions, account balances or disclosure.*" We are unclear as to what the term "amount" means in this context.

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control

3) Paragraph 10.4.1.(a) duplicates most of the requirements within ISA 600 (Revised) paragraph 30(a)(i) but omits requirement (c) "*The extent to which the group's business model integrates the use of information technology (IT)*". In our view, this omission is problematic because of the risk that the auditor does not obtain sufficient understanding on this area of the entity's control environment. It is also our view that this level of understanding could be relevant and necessary to the circumstances of a group audit engagement to which the proposed ISA for LCE is eligible. In response to this omission, we recommend that the IAASB re-evaluates whether this specific requirement has already been appropriately and sufficiently addressed through paragraph 6.3.1.