

Our Ref.: C/AASC

Sent electronically through the IAASB Website (www.iaasb.org)

2 May 2023

International Auditing and Assurance Standards Board
529 Fifth Avenue, 6th Floor
New York, NY 10017
USA

Dear Sirs,

The IAASB's 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) and Proposed Conforming Amendments*

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only statutory body in Hong Kong that sets auditing and assurance standards, ethical standards, financial reporting standards as well as sustainability disclosure standards for professional accountants in Hong Kong. We welcome the opportunity to provide our comments on the captioned IAASB Exposure Draft (ED).

As suggested in our response to the *Exposure Draft, Proposed International Standard on Auditing of Financial Statements of Less Complex Entities* ("ED-ISA for LCE" or "LCE standard"), we welcome the IAASB's decision to include audits of group financial statements in the application of the LCE standard.

However, our stakeholders consider the prohibition to use component auditors in a group audit engagement under the LCE standard (other than in limited circumstances) is too restrictive. In Hong Kong, it is common for groups that are not complex to have subsidiaries situated in Mainland China or overseas with the involvement of component auditors. Meanwhile, various laws and regulations in Mainland China impose cross border restrictions which may prevent auditors in Hong Kong to gain remote access to accounting records of companies established in Mainland China. Due to the restricted access imposed by laws or regulations in Mainland China, it may be necessary for the group auditor to use component auditors in group audit engagements regardless of the complexity of the group. Accordingly, we recommend the IAASB to expand the scope of the limited circumstances referred to in paragraph A.3., i.e., in addition to an inventory count and asset count, to allow the use of component auditors in situations of restricted access to the component due to laws and regulations.

To facilitate the use of the standard in group audit engagements, we also recommend the IAASB to incorporate guidance on how to overcome the restriction to access the component in the absence of component auditors.



With respect to the proposed group-specific qualitative characteristics, we are concerned with the drafting of “access to information or people” and “consolidation process” set out in the proposed paragraph A.3. We recommend the IAASB to re-consider the drafting so as to enhance the applicability of the proposed standard for group audits.

Our responses to the specific questions are included in the attachment. We trust that our comments are of assistance to you. If you have any questions regarding the matters raised above, please contact Selene Ho, Deputy Director of the Standard Setting Department (selene@hki CPA.org.hk).

Yours faithfully,

Cecilia Kwei
Director, Standard Setting Department

Question 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?

We acknowledge the IAASB's view that extensive use of component auditors would not be the intended design of ISA for LCE. Involving component auditors would lead to substantial additional procedures by the group auditor, such as assessing their competence and capabilities; instructing them; communicating with them and reviewing their work, which would increase the volume of the proposed standalone standard and make the proposed Part 10 no different from or as complicated as ISA 600 (Revised).

However, some of our stakeholders consider it too restrictive to prohibit the use of component auditors (other than under limited circumstances) in a group audit engagement under ISA for LCE. They consider the presence of a component auditor is not always a driver for complexity. In Hong Kong, it is common for groups that are not complex to have subsidiaries situated in Mainland China or overseas. Using component auditors situated in the same jurisdiction as the overseas subsidiary could enhance the efficiency and effectiveness of the group audit, such as eliminating the travelling needs; leveraging the component auditors' knowledge on the overseas environment and legal requirements, etc. Accordingly, some of our stakeholders consider the prohibition too restrictive and would reduce the applicability of the standard in group audit situations, hence practitioners would still have to use the full ISAs for some of their engagements which are otherwise less complex.

During the COVID-19 crisis, there were numerous circumstances that non-Hong Kong auditors (e.g., auditors from Mainland China) were involved in Hong Kong audits due to travel restrictions and Hong Kong auditors were not able to carry out physical inspection themselves or to verify the books and records of the clients kept overseas (e.g., as required under local legislation). Such assistance from other auditors was needed not because it was a "group audit"; it was also needed for an audit of a single company with operations in Mainland China. The arrangement could be regarded as the use of "borrowed staff" (within or outside the network) by the Hong Kong auditor to carry out certain audit procedures and not necessarily the engagement of a "component auditor". In the context of ED-ISA for LCE, we urge the IAASB to clarify whether the above situation would constitute the use of a component auditor, or merely the use of a "borrowed staff" without involving a component auditor.

It is also worth mentioning that due to relevant laws and regulations of Mainland China, accounting records of companies incorporated in Mainland China could not be taken out from Mainland China. However, the ED may not have been clear to describe circumstances that access to components may be restricted due to legal restrictions, and how to respond to such restrictions. Meanwhile, we note that paragraphs A179 to A180 of ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* describe situations of restricted access to component auditor documentation and provide guidance to the group auditor to overcome such restrictions.

To strike a balance between the IAASB's consideration and our stakeholders' comments on the use of component auditors, and in view of the access restrictions to accounting records of companies in Mainland China, we recommend the IAASB to consider the drafting of the LCE standard as follows:



- Expand the scope of the limited circumstances referred to in the proposed paragraph A.3., i.e., in addition to inventory count and asset count, allow the use of component auditors in case of restricted access to the component due to laws and regulations; and
- Develop guidance with reference to paragraphs A179 and A180 of ISA 600 (Revised), with appropriate modification, to assist auditors using the LCE standard to overcome access restriction due to laws and regulations, for example, in the case of companies incorporated in Mainland China as we describe above.

In addition, our stakeholders observe that other circumstances that might require an auditor's physical presence for a specific audit procedure might include:

- Obtaining a confirmation from the bank or relevant organization directly; and
- Site visit of major customers and/or suppliers.

We appreciate that the LCE standard applies a principle-based approach, hence, it is not possible for the IAASB to develop an exhaustive list on all scenarios to a particular circumstance or requirement. We would leave it to the IAASB to decide whether further illustrative examples such as the above should be incorporated into paragraph A.1. on circumstances requiring auditors' physical presence for a specific audit procedure.

To reduce the complexity and uncertainty of involving component auditors in those limited circumstances, we recommend the LCE standard to require the group auditor be specific on the nature and extent of audit procedures assigned to the component auditors, e.g., types of audit procedures, number of samples, etc.

Question 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?

With respect to the proposed group-specific qualitative characteristics set out in paragraph A.3., we would like to draw the IAASB's attention on the following comments:

Access to Information or People

Paragraph 19(b) of ISA 600 (Revised) specifies that as part of the terms of the engagement, the group auditor should obtain the agreement of the group management that the engagement team could request additional information from the group management or component management for the purpose of the group audit.

On *Access to Information or People* in the proposed Part 10 of the ED, we note that the drafting of paragraph A.3. only refers to the provision of access to information or people by the group management.

Given that component auditors are allowed in limited circumstances, we suggest the IAASB to clarify or re-consider the drafting on whether access to information and people could be provided

by the component management in addition to the group management to align with ISA 600 (Revised).

Consolidation Process

In paragraph A.3., one of the examples of a simple consolidation process is that financial information of all entities and business units has been prepared in accordance with the same accounting policies applied to the group financial statements. However, it is common for entities or business units not in the same territory as the holding company to prepare their financial information following local accounting requirements which may be different from the holding company's accounting policies. Adjustments made during the consolidation process for alignment with the group's accounting policies, in many instances, might be straight forward and not necessarily complex. We therefore suggest the IAASB to re-consider the drafting in this regard.

We also recommend the IAASB to clarify whether groups with entities or business units having a different reporting period-end judged to be immaterial or non-substantial (e.g., timing differences of less than a certain threshold; the aggregate quantitative impact due to timing differences is judged to be immaterial) are eligible for the LCE standard in their group audit engagements.

Another example of a simple consolidation process in paragraph A.3. is that there are no sub-consolidations. However, it is common for simple and less complex groups to have one or more than one sub-consolidation, e.g., an ultimate holding company holding an intermediate company, which holds two to three subsidiaries. The example in paragraph A.3 would prohibit less complex group audit engagements with simple, straight forward sub-consolidations to apply the LCE standard. Accordingly, we suggest the third example under "Consolidation Process" in paragraph A.3. be fine-tuned to "*There are no complex sub-consolidations*". In doing so, the IAASB should provide guidance on the context of "not complex", for example, the number of sub-consolidations and/or consolidation adjustments involved.

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

While we generally agree with the content of proposed Part 10 and related conforming amendments, we have the following observations for the IAASB's consideration:

Objective

The proposed paragraph 10.1 only includes one out of the four objectives set out in paragraph 13 of ISA 600 (Revised).

Following our recommendation set out in Q1 above, should the IAASB decide to expand the use of component auditors to circumstances of restricted access to the components due to laws and regulations, we would suggest the objective of proposed Part 10 to incorporate the objective set out in paragraph 13(c) of ISA 600 (Revised), and other paragraphs of ISA 600 (Revised) relevant to paragraph 13(c) into proposed Part 10.

Preface ISA for LCE

For the addition to paragraph P.12. of the Preface, to stress the application of Part 10 in a group audit engagement, one of our stakeholders suggests changing “special considerations” to “additional considerations”:

P.12. The [draft] ISA for LCE includes:

- ...
- *Part 10, which sets out ~~special~~ **additional** considerations that apply to an audit of group financial statements (a group audit). When the ISA for LCE applies to a group audit, the requirements and guidance in Part 10 refer to, or expand on the application of other relevant parts of the ISA for LCE to a group audit.*

We understand that the use of “special considerations” would align with the title and terms used in ISA 600 (Revised). Accordingly, we would leave the above comment for the IAASB to consider.

Acceptance or continuance of the group audit engagement

Paragraph 10.2.2. of the ED states that “*If, after the acceptance or continuance of the group audit engagement, the engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the engagement partner shall consider the possible effects on the group audit.*”

We note that paragraph 10.2.2. is adopted from paragraph 18 of ISA 600 (Revised). In ISA 600 (Revised), paragraph 18 is accompanied by application materials providing guidance on possible responses by the group auditor against the circumstance.

We are conscious that paragraph 10.2.2. alone may not be very useful as it does not explain the expected response. We suggest the IAASB to expand paragraph 10.2.2. by incorporating relevant guidance, such as those provided to paragraph 18 of ISA 600 (Revised).

Illustrative reports

We note that the IAASB anticipates to include illustrative reports relevant to group audits in the Non-Authoritative Supplemental Guide on Reporting after finalization of the proposed ISA for LCE. We welcome and appreciate the IAASB’s effort in this regard.

As suggested in our response to ED-ISA for LCE, Part 9 provides an illustrative auditor’s report on an unmodified opinion, but has not illustrated other types of opinions such as a qualified opinion, adverse opinion and unmodified opinion with material uncertainty relating to going concern which are included in the Reporting Supplemental Guide. For completeness and ease of use, we recommend that the IAASB to re-locate various illustrative opinions from the Reporting Supplemental Guide to the proposed standard, including those relating to group audits.

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