International Federation of Accountants
545 Fifth Avenue, 14th Floor, New York, NY 10017 USA
Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org

Revised
Agenda Item
2

Committee: IAASB
Meeting Location: Warsaw
Meeting Date: July 9-13, 2007

Proposed ISA 600 (Revised and Redrafted), "Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)"

Objectives of Agenda Item

1. To review the Task Force's recommendations with regard to the IAASB's comments received at the April IAASB meeting.
2. To approve the proposed ISA to be issued as a final ISA.

Task Force Members

3. The Task Force members are as follows:

   Jan Bo Hansen (Chair) (supported by Technical Advisory, Jennifer Haskell)

   John Fogarty

   Makoto Shinohara (supported by Technical Advisor, Yuichi Yamamoto)

   Will Rainey (supported by Technical Advisor, Jon Grant).

Task Force Recommendations

4. The text in the column on the left was extracted from the draft minutes of the April IAASB meeting.

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
The application material dealing with the application of the proposed ISA in audits of single entities and in the case of joint audits (paragraphs A1 and A2) should be moved to the Introduction section and the definition of "engagement partner" respectively.	The Task Force accepted this recommendation. See paragraphs 2 and 7(h).
To clarify the link between the proposed ISA and proposed ISA 220 (Redrafted). It was noted that paragraph 3 in the Component Auditors section is	The Task Force amended paragraph 5 to address this matter.

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
confusing as it may be read that the proposed ISA applies only to component auditors who are not from the group engagement partner's firm, which is not the case.	
Part (b) of the objective in paragraph 6, referring to "effectively communicate" with component auditors, should be changed to refer to communication with component auditors "on a timely basis." An IAASB member was of the view that the term "effective" is subjective, while the application material deals with timely communication.	The Task Force amended the objective in paragraph 8(b) as recommended.
The definition of "component auditor" (paragraph 7(b)) should be expanded to indicate that a component auditor performs work on the financial information of a component *at the request of the group engagement team.*	The Task Force amended the definition of "component auditor" in paragraph 8(b) as recommended.
The definition of "group engagement team" (paragraph 7(g)) should be changed so that it is not limited to partners and staff from the group engagement partner's firm, but also include partners and staff from a network firm who form an integral part of the group engagement team because of the tasks they perform on the group audit. This may be achieved by defining group engagement team in terms of its responsibilities, rather than the tasks it performs. As currently defined, the tasks are those performed by senior members of the group engagement team. It does not include procedures performed on the consolidation process and therefore may lead to a smaller team than what was intended. Mr. Kellas suggested that the group engagement team be defined in the context of the group engagement partner's responsibilities. For example, partners and staff (other than component auditors) who assist the group engagement partner in fulfilling his/her responsibilities for …"	The Task Force considered the comment and concluded that, based on the members' personal experience with group audits, partners and staff from a network firm rarely would be members of the group engagement team. Accordingly, the Task Force agreed to retain the definition of "group engagement team" in paragraph 7(g) of the April IAASB draft, but to expand it to also refer to work performed on the consolidation process. See paragraph 8(i) of the July IAASB draft.
The reference to components that have no parent in the definition of "group financial statements" (paragraph 7(h)) should be changed to components that have no parent but are under common control / ownership.	The Task Force did not accept this recommendation as it was concerned that the proposed change may imply that a parent exists.
Paragraph 9, dealing with the group engagement partner's responsibility for the group audit opinion, should be redrafted to focus on the fact	The Task Force revised paragraph 9 of the April IAASB draft to read as follows: "Because the group engagement partner or the group

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
that an unmodified auditor's report on group financial statements should not refer to a component auditor (unless otherwise required by law or regulation). If redrafted, the paragraph should be moved to a section towards the end of the Requirements section.	engagement partner's firm is responsible for the group audit opinion, the auditor's report on the group financial statements shall not refer to a component auditor." See paragraph 11 of the July IAASB draft. Based on comments on the March 2006 Exposure Draft and, in particular, those of the members of the Monitoring Group, the Task Force recommends that the reference to the responsibility of the group engagement partner / group engagement partner's firm be retained. The Task Force also recommends that the requirement be retained in its current position. The Task Force did not include the phrase "unless otherwise required by law or regulation" as it may be interpreted as implying that division of responsibility for the group audit opinion is acceptable if provided for by law or regulation. The Task Force recommends the following new application material (see paragraph A9): "When the group audit opinion is modified because the group engagement team was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the basis for the modification paragraph in the auditor's report on the group financial statements describes the reasons for that inability in accordance with [proposed] ISA 705 (Revised and Redrafted) without referring to the component auditor."
Paragraph 10, which requires the group engagement partner to determine whether appropriate procedures regarding acceptance and continuance have been followed in accordance with proposed ISA 220 (Redrafted), should be combined with paragraph 11, which requires the group engagement partner to determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained. In addition, consideration should be given as to whether the term "determine" in paragraph 11 should be replaced with the term "satisfied," as was the case in the exposure draft.	The Task Force combined the paragraphs as recommended. See paragraph 13. The Task Force agreed to retain the term "determine." Respondents to the March 2006 Exposure Draft and, in particular, those representing members of the Monitoring Group were of the view that the term "satisfied" was unclear. The Task Force is of the view that the term "determine" is correct, as the an evaluation would be based on a determination whether sufficient appropriate audit evidence can reasonably be expected to be obtained.
Components that are not under the control of the parent are sufficiently taken account of in the requirements on acceptance and continuance. In those cases, access will be restricted by	The Task Force is of the view that the guidance in paragraph A15 deals with this matter.

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
circumstances and not by management. The group engagement partner may therefore accept the engagement, but may still not be able to obtain sufficient appropriate audit evidence.	
The proposed ISA should be expanded to require the group engagement partner to approve the overall audit strategy and audit plan (paragraph 14).	The Task Force accepted this recommendation. See paragraph 17, which requires the group engagement partner to review the overall group audit strategy and group audit plan. Paragraph A23 contains related application material.
Application material should be developed to support the requirement that the group engagement team shall obtain an understanding of whether the component auditor operates in a regulatory environment that actively oversees and enforces the independence and professional competence of auditors, and the quality control systems of their firms (paragraph 17(d)).	The Task Force accepted this recommendation. See paragraph A37, which explains that, in some countries, independent oversight bodies have been established to oversee the auditing profession and monitor the quality of audits. Awareness of the regulatory environment may assist the group engagement team to evaluate the independence and competence of the component auditor. Information about the regulatory environment may be obtained from the component auditor or information provided by the independent oversight bodies.
The requirements on materiality should be revised to clarify that the "third level of materiality" / "tolerable error at the component level" is in line with proposed ISA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit," as it flows from the application of proposed ISA 320 (Revised and Redrafted) in the audit at the component level. Consideration should also be given as to whether the "second level of materiality" / "component materiality" and the "third level of materiality" / "tolerable error at the component level" could be combined in certain circumstances.	The Task Force agreed to delete the requirement for the group engagement team or component auditor to determine one or more amounts lower than component materiality for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks at the component level (i.e., the third level of materiality / "tolerable error" for the component). Paragraph A47 explains that, in the case of an audit of the financial information of a component, the component auditor (or group engagement team), in compliance with proposed ISA 320 (Revised and Redrafted), determines one or more amounts lower than the component materiality level for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks. Paragraph A47 also explains that, in practice, the group engagement team may set component materiality at this lower level. Paragraph 26 now requires the group engagement team to evaluate the appropriateness of the amount or amounts lower than the component materiality level determined for purposes of

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
	assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks at the component level (i.e., the third level of materiality / "tolerable error" for the component). This allows flexibility in relation to who determines this or these lower amounts.
The requirements on materiality should be limited to those in proposed ISA 320 (Revised and Redrafted) (i.e., materiality for the group financial statements as whole and component materiality (paragraphs 20 and 21)), and the additional requirements (paragraphs 22-23) moved to the application material. Although the proposed requirements are in line with proposed ISA 320 (Revised and Redrafted), they are far more detailed and procedural in nature, while different auditors may apply the concepts in proposed ISA 320 (Revised and Redrafted) in the context of a group audit in different ways. It may also help to move the application material on materiality to the Overall Audit Strategy and Audit Plan section.	The Task Force is of the view that the requirements and guidance in the ISA are in line with the principles established in proposed ISA 320 (Revised and Redrafted) and that they should be retained as proposed ISA 320 (Revised and Redrafted) does not deal with materiality in the context of a group audit. Further, the changes made in paragraph 26 in relation to the third level of materiality / "tolerable error" for the component should address some of the concerns.
To clarify the application of materiality in the context of a review of financial statements.	The Task Force developed paragraph A45, which explains that the group engagement team determines component materiality levels for those components whose financial information will be audited or reviewed, and that component materiality is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate.
To clarify how the requirements on determining the type of work to be performed on the financial information of components should be applied in the case where a group does not have any significant components.	The Task Force accepted the recommendation. See paragraph A54, which explains that a group may consist only of components that are not significant components. In these circumstances, the group engagement team can obtain sufficient appropriate audit evidence by determining the type of work to be performed on the financial information of the components in accordance with paragraph 33. Paragraph 33 deals with the selection of components that are not significant components and the type of work to be performed on the financial information of those components.
To clarify how the requirements on determining the type of work to be performed on the financial information of components that are not significant components should be applied in practice. If the analytical procedures are performed at group level	The Task Force deleted the phrase "at or near the end of the group audit" in paragraph 32 and A51. The group engagement team's decision whether to select components on which to perform work is based on a consideration whether sufficient

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
at or near the end of the group audit (paragraph 28) it may not leave sufficient time to perform work on the financial information of the components, should the group engagement team conclude that it has not obtained sufficient appropriate audit evidence (paragraph 29).	appropriate audit evidence will be obtained and is ordinarily made during the planning phase of the audit. See paragraph 33.
Based on a comment from an IAASB CAG Representative, the Consolidation Process section should be expanded to deal with the group engagement team's understanding of the consolidation process and tests of control.	The Task Force accepted this recommendation. See paragraph 36, which explains that: (a) The group engagement team obtains an understanding of group-wide controls and the consolidation process, including the instructions issued by group management to components. (b) The group engagement team, or component auditor at the request of the group engagement team, tests the operating effectiveness of group-wide controls if the nature, timing and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively, or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.
The list of matters to be communicated by the component auditor to the group engagement team should include identified or suspected fraud (paragraph 41) and, if the case, whether this should include all such fraud irrespective of materiality.	The Task Force accepted this recommendation. Paragraph 45(g) now requires the component auditor to communicate to the group engagement team fraud or suspected fraud involving component management, employees who have significant roles in internal control at the component level or others where the fraud resulted in a material misstatement of the financial information of the component.
The requirements or guidance should be expanded / changed to clarify the group engagement partner's responsibility for review and documentation. Reference was made to Article 27 of the EC's 8th Directive.	See paragraphs 5-~~7~~8 below.
To expand the proposed ISA to include a requirement for the component auditor to cooperate with the group engagement team.	The Task Force accepted this recommendation. See paragraph 12, which requires the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, to cooperate with the group engagement team. Paragraph A10 contains related application material.
To expand Appendix 1 to include an illustration of	The Task Force accepted this recommendation.

Matters for Consideration by the Task Force (Paragraph references are to those in the April IAASB draft)	**Task Force Recommendations** (Paragraph references are to those in the July IAASB draft unless otherwise stated)
a group auditor's report that contains a disclaimer of opinion.	See appendix 1, which now includes an example of a disclaimer of opinion.

5. Article 27 of the EC's 8th Directive requires Member States to ensure that, in the case of a statutory audit of the consolidated accounts of a group of undertakings:

   (a) The group auditor bears the full responsibility for the audit report in relation with the consolidated accounts;

   (b) The group auditor carries out a review and maintains documentation of his or her review of the audit work performed by third-country auditor(s), third-country audit entity(ies) or audit firm(s) for the purpose of the group audit. The documentation retained by the group auditor shall be such as enables the relevant competent authority to review the work of the group auditor properly ~~When a component of the group is audited by a statutory auditor or audit firm approved in a Member State other than that of the group auditor, the group auditor maintains documentation of his review of the audit work performed by the other statutory auditor or audit firm~~;

   (c) When a component of ~~the~~ a group of undertakings is audited by ~~an~~ auditor(s) or audit ~~firm~~ entity(ies) from a third country that has no working arrangement as referred to in Article 47 ~~that is not approved in a Member State~~, the group auditor is responsible for ensuring proper delivery, when requested, to the public oversight authorities of the documentation of the audit work performed by the third-country auditor(s) or audit entity(ies), including the working papers relevant to the group audit. To ensure such delivery, the group auditor shall retain~~s~~ a copy of ~~the~~ such documentation, or alternatively agree with the third-country auditor(s) or audit entity(ies) his proper and unrestricted access upon request, or take any other appropriate action ~~of the audit work performed by the other auditor or audit firm, including a copy of the audit working papers, solely for the purpose of the group audit~~. If legal or other impediments prevent audit working papers from being passed from a third country to the group auditor, the documentation retained by the group auditor shall include evidence that he or she has undertaken the appropriate procedures in order to gain access to the audit documentation, and in the case of impediments other than legal ones arising from country legislation, evidence supporting such an impediment.

6. The Task Force believes that the new requirement in paragraph 11 and the related application material emphasize the fact that the group engagement partner, or the group engagement partner's firm, bears *full responsibility* for the group audit opinion. This is enhanced by the definition of "group engagement partner" in paragraph 8(h) and the fact that the group engagement partner is required to:

   (a) Decide about accepting or continuing the group audit engagement (see paragraph 13-14);

(b) Agree the terms of the group audit engagement (see paragraph 15);

(c) Review the overall group audit strategy and group audit plan (see paragraph 17);

(d) Conclude whether the work of the component auditor is insufficient and, if the case, determine what additional procedures are to be performed, and whether they are to be performed by the component auditor or by the group engagement team (see paragraph 47);

(e) Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the component auditors on the financial information of the components, on which to base the group audit opinion (see paragraph 48); and

(f) Evaluate the effect on the group audit opinion of any misstatements (either identified by the group engagement team or communicated by component auditors) and any instances where there has been an inability to obtain sufficient appropriate audit evidence (see paragraph 49).

7. The proposed ISA deals with the group engagement team's *review* of a component auditor's work as follows:

(a) In the case of significant components, paragraph 34(a) requires the group engagement team to review the component auditor's documentation of identified significant risks of material misstatement of the group financial statements.

(b) In the case of identified significant risks of material misstatement of the group financial statements, paragraph 35 requires the group engagement team to evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial statements. Based on its understanding of the component auditor, the group engagement team has to determine whether it is necessary to be involved in the further audit procedures.

(c) Paragraph 46 requires the group engagement team to evaluate the component auditor's communication. The group engagement team has to discuss significant matters arising from that evaluation with the component auditor, component management or group management, as appropriate; and determine whether it is necessary to review other relevant parts of the component auditor's audit documentation.

(d) Paragraph A56 explains that forms of involvement in the work of a component auditor other than those described in paragraphs 34-35 and 46 may, based on the group engagement team's understanding of the component auditor, include one or more of the following:

(i) Meeting with component management or the component auditors to obtain an understanding of the component and its environment.

(ii) Reviewing the component auditors' overall audit strategy and audit plan.

(iii) Performing risk assessment procedures to identify and assess the risks of material misstatement at the component level. These may be performed with the component auditors, or by the group engagement team.

(iv) Designing and performing further audit procedures. These may be designed and performed with the component auditors, or by the group engagement team.

(v) Participating in the closing and other key meetings between the component auditors and component management.

(vi) Reviewing other relevant parts of the component auditors' audit documentation.

~~7.~~8. Paragraphs 44 and 45 prescribe matters to be communicated by the component auditors to the group engagement team. Paragraph A59 recognizes that communication between the group engagement team and the component auditor may not necessarily be in writing. However, the *documentation* requirements of proposed ISA 600 (Revised and Redrafted) and other ISAs nevertheless apply. Paragraph 55 requires the group engagement team to document in addition to the documentation requirements in ISA 230 and other ISAs:

(a) An analysis of components, indicating those that are significant, and the type of work performed on the financial information of the components.

(b) The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components.

(c) Communications between the group engagement team and the component auditors about the group engagement team's requirements.

The Task Force is of the view that the~~se~~ review and documentation requirements are sufficient and in line with the extent of review and documentation generally required by the ISAs.

Material Presented

Agenda Item 2-A (Pages 1511 – 1560)	Proposed ISA 600 (Revised and Redrafted) – MARK-UP FROM APRIL 2007 IAASB DRAFT
Agenda Item 2-B (Pages 1561 – 1606)	Proposed ISA 600 (Revised and Redrafted) – CLEAN
Agenda Item 2-C (Pages 1607 – 1622)	Draft Basis for Conclusions

Action Requested

~~8.~~9. The IAASB is asked to review the Task Force's recommendations with regard to the IAASB's comments received at the April IAASB meeting and to approve the proposed

ISA to be issued as a final ISA. **This memorandum together with Agenda Items 2-A will form the basis for the discussion.**

~~9.~~10. IAASB members are also asked to forward any comments that they may have on the draft Basis for Conclusions to Alta Prinsloo at altaprinsloo@ifac.org; either before, during or shortly after the July IAASB meeting.