

ISA 600, *Special Considerations—Audits of Group Financial Statements* (Including the Work of Component Auditors)

Objective of the IAASB Discussion

The objective of this agenda item is to update the Board on the work performed by the Group Audit Task Force (the Task Force) since the start of the project to revise ISA 600 and to obtain the Board's views on the Task Force's direction on certain identified issues as presented in **Agenda Item 2** and **Agenda Item 2-A**.

Introduction

1. The Task Force recognizes that many Board members were not involved in the Board's deliberations on Group Audits as the last discussion on ISA 600 was over a year ago. This paper therefore provides background information on the project, discusses the issues identified to date and a possible way forward as discussed by the Task Force.
2. For Board members who wish to further familiarize themselves with the project, the Task Force recommends reading:
 - **Supplement A to Agenda Item 2:** Invitation to Comment (ITC), *Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits*;
 - **Supplement B to Agenda Item 2:** Agenda Item 5-C for the September 2016 Board meeting; and
 - **Supplement C to Agenda Item 2:** Project update, *Enhancing Audit Quality Focusing on Group Audit*.
3. This agenda item includes background information on the work performed by the Task Force since the start of the project to revise ISA 600 (see section I) and explains how the Task Force has further considered and addressed the following issues:
 - Scoping a group audit engagement (see section II)
 - Definitions (see section III)

Other issues are summarized in **Agenda Item 2-A**, which also describes the linkage to the foundational standards and possible actions to address the issues. The table included in **Agenda Item 2-A** will be a key focus of the Board's discussion at the March 2019 IAASB meeting.
4. Section IV provides background information and includes questions for the Board with respect to the table included in **Agenda Item 2-A**. The Task Force's proposed way forward is set out in Section V.
5. **Appendix 1** to this agenda item contains an overview of the Task Force members and the Task Force's activities since the December 2017 meeting. An extract of the draft December 2017 meeting minutes on Group Audits is included in **Appendix 2** to this agenda item.

Section I: Background

Project Proposal

6. The IAASB approved the [project proposal](#) for Quality Control and Group Audits in December 2016 based on:
 - Findings from the ISA Implementation Monitoring project, which are discussed in the 2013 publication, [Clarified International Standards on Auditing-Findings from the Post-Implementation Review](#);
 - Responses to the ITC related to Group Audits, which were summarized and presented to the IAASB at the September 2016 meeting (See section A of [Agenda Item 5-A](#) for the September 2016 meeting and **Supplement B to this agenda item**);¹ and
 - Other input gathered during related outreach activities, including roundtables and country visits, as well as discussions with the IAASB Consultative Advisory Group (CAG).
7. The approved project proposal indicates that the IAASB will consider:
 - The current requirements of ISA 600 as they relate to the scoping of a group audit and what revisions are required in order to sufficiently focus the auditor's attention on identifying, assessing and responding to the risks of material misstatement to the group financial statements.
 - Clarifying and reinforcing in ISA 600 that all ISAs, when applicable, need to be applied in a group audit engagement through establishing stronger linkages to the other ISAs, in particular to ISA 315 (Revised)² and ISA 220.³
 - Strengthening and clarifying how ISA 600 addresses:
 - Communication between the group engagement team and component auditors, facilitating a stronger two-way communication.
 - Various aspects of using the work of component auditors, including understanding the independence, competence and capabilities of the component auditor and determining the appropriate extent of involvement of the group engagement team in the work performed by component auditors.
 - The work effort that is appropriate in relation to:
 - Components identified for further work effort; and
 - Non-significant components. This includes considering the 'residual risk' in the non-significant components and whether this risk is adequately addressed by the planned audit procedures.
 - The work effort of the group engagement team in relation to the consolidation process.

¹ The Task Force continues to analyze the responses to the ITC related to Group Audits and will provide more detail on the responses when discussing the identified issues in ISA 600.

² ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

³ ISA 220, *Quality Control for an Audit of Financial Statements*

- The group engagement team's evaluation about whether sufficient appropriate audit evidence has been obtained.
8. The IAASB also agreed to explore what more can be done in ISA 600 in relation to clarifying the concepts of component materiality and aggregation risk (i.e., the risk that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole). Both performance materiality and the determination of whether to audit at the group level or component level are based on the concept of minimizing aggregation risk. The IAASB does not however contemplate that the project to revise ISA 600 would involve broader changes to ISA 320⁴ or ISA 450.⁵

Work since Approval of the Project Proposal

9. Since the approval of the project proposal the Task Force discussed various topics including:
- Scoping of a group audit engagement (see section II below);
 - Acceptance and continuance, including:
 - Placing particular focus on identifying, to the extent possible as part of acceptance or continuance conclusions, situations where there may be difficulty in obtaining sufficient appropriate audit evidence, including where access to component management, the component auditor or audit evidence obtained by any component auditor may be restricted (e.g., where investments are accounted for using the equity method of accounting or where restrictions are imposed by local law or regulation, including data privacy laws); and
 - Considerations regarding the terms of engagement;
 - The need for robust, timely and two-way communications between the group engagement team and the component auditors; and
 - The necessary work effort of the group engagement team in relation to the consolidation process, particularly regarding sub-consolidations.
10. In September 2017, the IAASB noted that several revisions to ISA 600 are contingent upon the revisions being made to other foundational standards such as ISQC 1,⁶ ISA 220 and ISA 315 (Revised). As the IAASB had a number of priority projects on its agenda, coupled with finite staff resources and Board capacity, the IAASB decided that the Task Force would focus its efforts on further liaison with the task forces responsible for revisions to ISQC 1, ISA 220, and ISA 315 (Revised) before progressing the other aspects of the ISA 600 project any further (i.e., providing necessary input to assist in how issues relevant to group audits are addressed in the revisions to those standards).
11. In October 2017, the Task Force prepared a project update (see **Supplement C to Agenda Item 2**) to provide an update about the issues under consideration in the revision of ISA 600, and other projects that address other international standards, in particular, ISA 220 and ISQC1. The project update also explains the linkages between these projects as they relate to group audit issues.

⁴ ISA 320, *Materiality in Planning and Performing an Audit*

⁵ ISA 450, *Evaluation of Misstatements Identified during the Audit*

⁶ International Standards on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

Section II: Scoping a Group Audit Engagement

12. The Task Force had extensive discussions on the scoping of group audits and discussed its plans with the IAASB in its September 2016 meeting (see [Agenda Item 5-C](#)) and December 2017 meeting (see [Presentation](#)).
13. At the September 2016 meeting the Task Force proposed to explore a better articulation of a risk-based approach to the scoping of a group audit, including the work to be done at the component level (also referred to as the 'top-down approach'). This approach included more focus on identifying and assessing risks at the group level and determining that the planned scope of work adequately responds to those risks, rather than the current approach whereby the scope of the work is driven primarily by the identification of components and determination of their significance. The Task Force was of the view that scoping the work effort, based on the identification of components and the determination of their significance, appeared to be an underlying cause of a number of the challenges and concerns raised in response to the ITC.
14. The Task Force was also of the view that this approach will more closely align ISA 600 with the principles in ISA 315 (Revised) and ISA 330 (Revised).⁷ See also linkages with foundational standards discussed in paragraph 31.
15. Board members generally supported further exploring strengthening the way that the risks of material misstatement are identified and assessed at the group financial statement level and responded to at the group and component level. They highlighted that the approach would need to:
 - Be capable of being applied in a wide variety of circumstances; and
 - Scalable and understandable.
16. In 2017 the Task Force met twice to further explore the revised approach and at the December 2017 meeting, the Task Force presented its latest thinking of the top-down approach.
17. The Task Force believed that ISA 600 should be structured to help group engagement teams focus on determining that appropriate audit procedures are planned and performed to address the risks of material misstatement of the group financial statements. Enhancements to ISA 600 could be incorporated to focus on the auditor's evaluation as to whether and how the risks are addressed through work done at the group level by the group engagement team and through work done at the component level by component auditors.
 - The top-down approach would provide a framework for further exploration of the nature of the work to be done by component auditors and to address many of the issues highlighted in the table included in **Agenda Item 2-A**. For example, under a top-down approach to group audit scoping, it would become clearer as to which risks and related account balances would be audited in the aggregate or at a group level by the group engagement team, and also how that work would be relevant to determining whether incremental work would be necessary at the component level, and if so, what that would entail.
 - The Task Force was of the view that understanding the entity's operational structure remains foundational to the auditor's overall group audit strategy and group audit plan. In particular, in identifying and assessing the risks of material misstatement at the group financial statement level and in developing appropriate responses, the corresponding work effort will, in many cases, most

⁷ ISA 330, *The Auditor's Responses to Assessed Risks*

appropriately be undertaken at the component level. In linking the determination of the work to be done at the component level more closely with the risks identified at the group level, the group engagement team would be able to more appropriately direct the work to be done at the component level that is necessary to support the group audit opinion.

Matters for IAASB Consideration

1. The IAASB is asked whether it continues to support developing the top-down, risk based approach, and whether there any other matters the Task Force should consider in developing this approach.

Section III: Definitions

18. It was noted in the ITC that some stakeholders view the interaction of the requirements, definitions, and guidance in ISA 600 as causing difficulty in practice, including in situations when the definitions as set forth in ISA 600 do not apply to a particular engagement. Accordingly, the ITC acknowledged that certain definitions in ISA 600, many of which are interrelated, may need to be reconsidered. For example, a change in the definition of component also affects several other definitions (e.g., significant component, group financial statements, group audit). It may also be necessary to consider the definition of group engagement team, and whether it is clear how it relates to the definition of engagement team in ISA 220 (Revised).⁸

Component

19. Extant ISA 600 includes the following definitions of a component, significant component and group financial statements:

Component – An entity or business activity for which group or component management prepares financial information that should be included in the group financial statements. (Also see application material ISA 600 paragraphs A2-A4)

Significant component – A component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements.

Group financial statements – Financial statements that include the financial information of more than one component. The term “group financial statements” also refers to combined financial statements aggregating the financial information prepared by components that have no parent but are under common control.

20. Respondents to the ITC noted that practical challenges have arisen in terms of applying the definition of components, including the lack of adaptability of the definition in light of evolving or more complex group structures. Questions have also been raised about:
 - Whether investments that are carried at cost or measured at fair value meet the definition of components in ISA 600, and about the applicability of ISA 600 to audits of financial statements that include investments of this nature, for example, as would likely be the case in “fund of funds” structures.

⁸ Proposed ISA 220 (Revised), *Quality Control for an Audit of Financial Statements*

- Whether, and if so, how ISA 600 applies to situations where a shared service center is used. In some circumstances, the shared service center may be treated as a separately identifiable component. In other circumstances, a shared service center may not be considered a separate component based on applying the definition of a component in ISA 600.

Significant Component

21. With respect to the definition of significant component, questions have been raised about:

- The interaction of “significant risks” and “significant components,” i.e., how the identification of significant risks at the component level impacts the determination of whether a component is a significant component. Significant components are identified either based on financial metrics or whether components are likely to include significant risks⁹ (determined in accordance with ISA 315 (Revised)).¹⁰ As the identification and assessment of significant risks is also linked to the identification of significant components, it has been noted that ISA 600 does not provide much guidance as to how significant risks that are pervasive to the group (and which therefore potentially exist at all components) are to be taken into account in determining significant components. It has been noted that the relevant definitions may need to be reconsidered.
- What is meant by the reference in the definition to “individual financial significance.”

Group Financial Statements and Group Audit

22. As noted above, the definitions of group financial statements and group audit are dependent on the definition of components, so any issues identified with the definition of component also impact the definitions of group financial statements and group audit.

Way Forward

23. Based on the responses to the ITC, the Task Force recognizes the need to acknowledge the existence of evolving environments and increasingly complex group structures and, to the extent possible, address any issues with the definitions and related application material. Accordingly, the Task Force will consider whether the definition of component should be changed, taking into account:

- The interaction of the definition of component with:
 - The top-down approach;
 - Other (component) auditors; and
 - Requirements of the applicable financial reporting framework;
- The adoption of a principles-based definition that allows audit teams to take into account both entity and audit operational structures in determining the scoping of their group audits; and
- Whether the definition of a component (and thus whether the engagement is a group audit) should be based on whether other (component) auditors are used on the engagement and not based on the structure of the entity itself.

⁹ ISA 600, paragraph 9(m)

¹⁰ ISA 315 (Revised), paragraph 27

Group Engagement Team

24. Extant ISA 600 includes the following definition of the group engagement team:

Group engagement team – Partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial statements.

25. The exposure draft of proposed ISA 220 (Revised) (ED-220) includes the following definition of engagement team:

Engagement team – All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, including individuals engaged by the firm or a network firm. The engagement team excludes an auditor's external expert engaged by the firm or a network firm, and also excludes individuals within the client's internal audit function who provide direct assistance on an engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).

26. In addition to clarifying the links between ISA 600 and ISA 220, respondents also requested that it was important to clarify which engagement participants fall within or outside the definitions of group engagement team and component auditor given different and evolving team structures, including when a group engagement team also functions as a component auditor(s).
27. The Task Force noted that changes have been made to the definition of the engagement team in ED-220 to recognize different and evolving engagement team structures. In particular, ED-220 now recognizes that engagement teams may be organized in a variety of ways, including being located together or across different geographic locations, or organized by the activity they are performing. ED-220 also recognizes that individuals who are involved in the audit engagement may not necessarily be engaged or employed directly by the firm. Importantly, the definition clarifies that, regardless of the location or employment status of such individuals, if they are performing audit procedures on the engagement, then they are a member of the engagement team and their work needs to be appropriately directed, supervised and reviewed.
28. In addition, the Task Force noted that there is not a term in extant ISA 600 to capture the entire team, the group engagement team and all the component auditors.

Way Forward

29. The Task Force will reconsider the definition of the group engagement team based on the revised definition of engagement team in ED-220. The Task Force will also consider clarifying which engagement participants fall within or outside the definitions of group engagement team and component auditor. In addition, the Task Force agreed that application material could include guidance for situations when a group engagement team also functions as a component auditor(s).
30. In addition, the Task Force will liaise with the International Ethics Standards Board for Accountants (IESBA) regarding the definition of group engagement team and interaction with the IESBA's *Code of Ethics for Professional Accountants*.

Matter for IAASB Consideration

2. The IAASB is asked for its views on the way forward proposed by the Task Force in respect to the definitions.

Section IV: Overview of Issues*Linkages with Other Standards*

31. Many respondents to the ITC supported clarifying and reinforcing in ISA 600 that all ISAs, when applicable, need to be applied in a group audit engagement through establishing stronger linkages to the other ISAs, in particular to ISA 315 (Revised) and ISA 220.
32. ISA 600 should specifically build on:
 - ISA 220 (Revised) (and indirectly ISQM 1)¹¹ with respect to quality management considerations at the firm and at the engagement level (including the involvement of the group engagement partner and the engagement team);
 - ISA 230¹² with respect to related documentation (including consideration of the need for strengthened documentation requirements in ISA 600);
 - ISA 240¹³ with respect to identifying and assessing the risks of material misstatement of the financial statements due to fraud;
 - ISA 315 (Revised) with respect to understanding the entity and its environment (including internal control) and the identification and assessment of risks of material misstatement;
 - ISA 320 with respect to applying materiality in planning and performing an audit of financial statements;
 - ISA 330 with respect to responding to the identified risks of material misstatement; and
 - ISA 500¹⁴ with respect to designing and performing audit procedure to obtain sufficient appropriate audit evidence.
33. The Task Force noted that these linkages could be enhanced in the revision of ISA 600 given that issues were noted related to the interaction between ISA 600 and other ISAs.

Overview of Issues

34. In exploring a way forward, the Task Force agreed that a number of the issues raised by respondents should be assessed in conjunction with the foundational ISA in which the topic is based (e.g. issues related to appropriate involvement of the group engagement partner in the component auditors' work have their roots in the requirements related to the responsibilities of the engagement partner which are addressed in ISA 220 (Revised)). Therefore, the Task Force developed a table (included in **Agenda Item 2-A**) that summarizes:

¹¹ Proposed International Standard on Quality Management (ISQM) (previously ISQC) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

¹² ISA 230, *Audit Documentation*

¹³ ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

¹⁴ ISA 500, *Audit Evidence*

- The issues identified. The issues identified are based on the ITC, the comments received on the ITC, Task Force discussion and outreach. All issues included in the table in **Agenda Item 2-A** are linked to a specific section in extant ISA 600 (the sections follow the subheadings in the current standard). In some cases, an issue may relate to more than one section of the standard.
 - The foundational standard. Given that ISA 600 builds on other ISAs, the Task Force is of the view that stronger linkage of ISA 600 with the foundational standards may, in part, address a number of issues. Many of the changes being proposed to the IAASB's quality management standards (ISQM 1, ISQM 2¹⁵ and ISA 220 (Revised) and ISA 315 (Revised) impact ISA 600 and therefore impact the possible actions needed to address the issue identified.
 - A possible action to address the issue taking into account the top-down approach as set out in Section II.
35. The issues included in the table in **Agenda Item 2-A** do not include all the issues identified with ISA 600, and refer to the following foundational ISAs:
- ISQM 1;
 - ISA 210;¹⁶
 - ISA 220 (Revised);
 - ISA 260 (Revised);¹⁷
 - ISA 315 (Revised);
 - ISA 330; and
 - ISA 700 (Revised)¹⁸

Other issues that have been identified in the ITC but have not been included in the table in **Agenda Item 2-A** are, for example, those related to component materiality, disclosures and documentation. These issues will be further discussed by the Task Force in due course in connection with the revisions to ISA 600.

Matters for IAASB Consideration

3. On **Agenda Item 2-A**, the IAASB is asked for its views on:
- a. The issues, including information about how they are being addressed in practice;
 - b. Whether additional issues have been identified since the publication of the ITC;
 - c. The summary of how the “foundational standards” relate to ISA 600; and
 - d. The possible action(s) identified to address the issue.

¹⁵ Proposed ISQM 2, *Engagement Quality Reviews*

¹⁶ ISA 210, *Agreeing the Terms of Audit Engagements*

¹⁷ ISA 260 (Revised), *Communication with Those Charged with Governance*

¹⁸ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

Section V: Way Forward

36. The Task Force will continue to work on a way forward on the issues related to scoping a group audit, the definitions, issues identified in the table in **Agenda Item 2-A** and other issues that have been identified in the ITC. For the June 2019 IAASB meeting, the Task Force will specifically focus on further developing the top-down approach to the scoping of a group audit engagement and on an initial outline of the revised standard.

Outreach

37. In connection with the revision of ISA 600, the Task Force will liaise with key stakeholders such as:
- Regulators, for example the International Organization of Securities Commissions' Committee 1, International Forum of Independent Audit Regulators' Standards Coordination Working Group and the Committee of European Auditing Oversight Bodies;
 - Practitioners, through the Forum of Firms, Global Public Policy Committee and the International Federation of Accountants' Small and Medium Practices Committee; and
 - International Ethics Standards Board for Accountants.
38. The Task Force will also continue to discuss the issues with, and provide updates on the project to, the IAASB CAG.

Appendix 1

Task Force Members and Activities, Including Outreach

1. The Task Force consists of the following members:

- Len Jui, Task Force Chair
- Robert Dohrer
- Rich Sharko
- Wolf Böhm
- Josephine Jackson
- Dora Burzenski (Correspondent member)

Task Force Activities since the December 2017 IAASB Discussion

2. The Chair and former Chair of the Task Force met with Staff in January 2019 and the Task Force had one teleconference in February 2019.

Appendix 2

Extracts from Draft December 2017 Minutes

Group Audits

Ms. Zietsman updated the Board about the coordination between the Group Audit Task Force (GATF) and other task forces currently revising standards, noting that the GATF continues to monitor the other projects, provides input as appropriate and considers the implications of changes in the other standards on ISA 600. She also added that the GATF is continuing its discussions on the “top-down” approach, which incorporates horizontal and vertical aspects of scoping a group audit engagement to facilitate a more effective approach to group audits. Mr. Gunn noted the importance of testing any changes in a number of circumstances to achieve proposals that are capable of being appropriately implemented. He suggested that the Task Force should consider testing the “top-down” approach to evaluate whether the requirements produce the desired outcome for different types of component auditors and group auditors, and different relationships between them.

WAY FORWARD

The GATF will continue to closely monitor the development of other relevant standards and continue to progress its work on revisions to ISA 600.