

## PROJECT UPDATE – ENHANCING AUDIT QUALITY FOCUSING ON GROUP AUDITS

***This publication has been prepared by the Group Audits Task Force (GATF) to provide an update about the issues being considered in the revision of ISA 600,<sup>1</sup> and other projects that are addressing other international standards, including ISA 220 and ISQC 1. It also explains the linkages between these projects as they relate to group audit issues.***

*It does not constitute an authoritative pronouncement of the International Auditing and Assurance Standards Board (IAASB), nor does it amend or override the International Standards on Auditing (ISAs).*

### Key Points

- ISA 600 deals with special considerations that apply in audits of group financial statements (group audits). Many of the requirements of ISA 600 are therefore drafted in the context of requirements in other standards. As noted in the [Enhancing Audit Quality: Project Proposal for the Revision of the IAASB'S International Standards Relating to Quality Control and Group Audits](#) (project proposal), the IAASB recognized that there is a strong linkage between the IAASB's work to clarify and strengthen ISA 600 and the projects to revise other standards, in particular ISQC 1,<sup>2</sup> ISA 220,<sup>3</sup> and ISA 315 (Revised).<sup>4</sup>
- Some foundational issues to be dealt with in the revisions to ISA 600 need to be first considered and addressed in these other projects, i.e., such that the Group Audit Task Force (GATF) can appropriately build on the revised requirements and application material in making necessary revisions to ISA 600.
- The GATF is working cooperatively with the task forces responsible for the revisions of ISQC 1, ISA 220, and ISA 315 (Revised) and providing input as proposed revisions to these standards are being progressed. This interaction with the other task forces will enable the GATF to be well positioned to reflect the revisions to these other standards in the context of ISA 600, and provide the additional context of the special considerations relevant to their application to group audits.

<sup>1</sup> International Standard on Auditing (ISA) 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

<sup>2</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

<sup>3</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

<sup>4</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

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## Background to the Group Audits Project

1. In 2013, the IAASB published its findings on its post-implementation review of the clarified ISAs.<sup>5</sup> Key findings from the post-implementation review included those related to group audits, as well as findings related to the IAASB's quality control standards (ISQC 1 and ISA 220) that are relevant also to group audits.
2. In developing its [Work Plan for 2015–2016](#), the IAASB agreed to focus on certain public interest issues noted in the ISA post-implementation review in relation to audit quality where key and important findings had indicated the need to consider changes to aspects of the relevant ISAs. Accordingly, the IAASB included projects on group audits and quality control in the 2015–2016 Work Plan.
3. Work commenced on quality control in June 2014, and on group audits in early 2015, with working groups reflecting on the issues identified through the ISA post-implementation review, inspection findings of audit oversight bodies, and from ongoing stakeholder outreach. For both topics it was agreed that further consultation was needed to better inform related standard setting proposals – recognizing that there was overlap between issues relating to quality control, group audits, and also professional skepticism (another project included in the 2015–2016 Work Plan).
4. The IAASB consulted publicly about these topics through the Invitation to Comment (ITC), [Enhancing Audit Quality: A Focus on Professional Skepticism, Quality Control and Group Audits](#), which was published in December 2015, with comments requested by May 16, 2016. The ITC included the issues identified and possible responses or actions that the IAASB could undertake.
5. In summary, the issues and possible responses discussed in the ITC relating specifically to group audits were as follows:
  - (a) Scoping a group audit – To clarify, and expand on, how a group engagement team (GET) is expected to apply the requirements in the standards related to identifying and assessing risks of material misstatement, and responding to those risks.

### **RESPONSES TO THE ITC RELATED TO GROUP AUDITS**

*Responses to the ITC were summarized and presented to the IAASB at the September 2016 meeting.<sup>6</sup>*

*Respondents to the ITC generally agreed with the identification of the issues relating to group audits, and generally supported the possible actions or responses that were proposed in the ITC. However, respondents across stakeholder groups expressed varying views on individual aspects.*

*There was also acknowledgement across a broad range of stakeholder groups that many of the issues related to group audits were likely implementation issues. Those respondents therefore cautioned that new or enhanced requirements may not necessarily be the best solutions to addressing these issues. It was also acknowledged that some practical challenges are not capable of being addressed through standard setting alone (e.g., certain issues related to working paper access that are attributable to privacy laws and regulations in certain jurisdictions).*

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<sup>5</sup> The findings of post-implementation review are discussed in the 2013 publication, [Clarified International Standards on Auditing-Findings from the Post-Implementation Review](#).

<sup>6</sup> Section A of [Agenda Item 5-A](#) of the September 2016 IAASB meeting.

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- (b) Acceptance and continuance issues – Considering the need for clarified requirements or enhanced guidance to drive more informed decisions. This includes proactive consideration of the situations where there may be restricted access to component financial information, to component management or component auditors when deciding to accept or continue the audit engagement, as well as addressing the related effect on planning and performing the group audit. Such restricted access situations may arise in a variety of circumstances, including when components are non-controlled entities or as a result of law or regulation.
  - (c) Using the work of component auditors – Strengthening the GET's required understanding of the component auditors. Enhancing and clarifying the requirements and guidance addressing direction, supervision and review of the work of the component auditors. Emphasizing the importance and relevance of the GET's evaluation of the competence and capabilities of component auditors when planning the necessary direction and supervision activities and review of the work of component auditors.
  - (d) Involvement of the group engagement partner in the group audit – Strengthening the requirements or guidance around the involvement of the group engagement partner and GET in the group audit.
  - (e) Two-way communication – Developing more robust requirements or guidance for timely two-way communication between the GET and the component auditors.
  - (f) Component materiality – Clarifying the guidance relating to determining and applying component materiality in the context of ISA 320.<sup>7</sup>
  - (g) Link with other ISAs – Clarifying the interaction with other ISAs, e.g., with:
    - ISQC 1 and ISA 220 on quality control considerations at the firm and at the engagement level;
    - ISA 315 (Revised) on understanding the entity and its environment (including internal control) and the identification of risks of material misstatement;
    - ISA 330<sup>8</sup> on responding to the identified risks of material misstatement; and
    - ISA 230<sup>9</sup> on related documentation (including consideration of the need for strengthened documentation requirements in ISA 600).

#### *Crossover Issues with Other Current IAASB Projects*

- 6. The ITC included a discussion of issues that were considered relevant to more than one of the quality control, group audits and professional skepticism projects. The “crossover issues” identified in the ITC were as follows:
  - (a) Engagement partner roles and responsibilities;
  - (b) Others involved in the audit (i.e., an engagement quality control reviewer, a component auditor, another auditor, and an auditor's expert);

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<sup>7</sup> ISA 320, *Materiality in Planning and Performing an Audit*

<sup>8</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>9</sup> ISA 230, *Audit Documentation*

- (c) Consideration of networks; and
- (d) Alternative delivery models for audits.

Many of the group audit issues are directly related to these crossover issues. For example, questions have arisen regarding the engagement partner's roles and responsibilities in a group audit situation, including:

- The appropriate involvement of the group engagement partner in the group audit;
- What is required for the group engagement partner to be satisfied about the collective competence and capabilities of those performing the group audit engagement, including component auditors; and
- How to demonstrate that the group engagement partner is executing his or her responsibilities related to the direction, supervision and review of the group audit engagement, including evaluating the component auditors.

#### **WHEN THE ENGAGEMENT PARTNER IS NOT LOCATED WHERE THE MAJORITY OF THE AUDIT WORK IS PERFORMED**

*Concerns have been raised related to the performance of audits in circumstances when engagement partners are not located where the majority of the audit work is performed. These concerns focused, in particular, on circumstances when entities are structured such that the entity is legally registered or maintains a correspondence address in one jurisdiction and the majority of the general and financial management business activities and transaction processing occurs in a different jurisdiction.<sup>10</sup>*

A Staff Audit Practice Alert, [Responsibilities of the Engagement Partner in Circumstances when the Engagement Partner Is Not Located Where the Majority of the Audit Work is Performed](#), was developed to remind auditors of the responsibilities of the engagement partner when performing audits in accordance with the ISAs.

*The ISA 220 Task Force (ISA 220 TF) is considering how to embed quality management principles into ISA 220 and how best to strengthen the requirements regarding the engagement partner's overall responsibility for the quality of the engagement and the nature, timing and extent of necessary involvement in the work done by other members of the engagement team, including other auditors (component auditors in the case of audits of group financial statements).*

#### **Recent Activities of the GATF**

7. Based on responses to the ITC and other input gathered during related outreach activities, including roundtables and country visits, as well as discussions with the IAASB Consultative Advisory Group (CAG), the IAASB approved the project proposal for quality control and group audits in December 2016.

#### *Project Proposal – Group Audits*

8. The approved project proposal indicates that the IAASB consider:
  - The current requirements of ISA 600 as they relate to the scoping of a group audit. (i.e., an approach that includes the identification of significant components and a description of the expected work efforts to be directed at such components) and whether revisions are required

<sup>10</sup> Referred to by some as audits of letterbox companies.

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in order to sufficiently focus the auditor's attention on identifying 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) and ISA 220 (as revised).
- Strengthening and clarifying how ISA 600 addresses:
  - Communication between the GET and component auditors, facilitating a stronger two-way communication.
  - Various aspects of using the work of component auditors, including understanding the component auditor and determining the appropriate extent of involvement of the GET in the work performed by component auditors.
  - The work effort and types of procedures that are appropriate in relation to significant and non-significant components.
  - The work effort of the GET in relation to the consolidation process.
  - The GET's evaluation about whether sufficient appropriate audit evidence has been obtained.

9. 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. The IAASB does not however contemplate that the project to revise ISA 600 would involve broader changes to ISA 320.

#### *Activities of the GATF*

10. To date, the GATF has discussed the following issues:

- Scoping of a group audit engagement, including:<sup>11</sup>
  - Obtaining an understanding of the group and its components (including group structures and use of shared service centers);
  - Considering the understanding of each component auditor in determining the extent of involvement by the GET in the work of each component auditor (recognizing that this will vary for different component auditors – in particular the considerations for component auditors that are members of the same firm or network of firms as the GET may be different from those relevant to component auditors from other firms or networks,);
  - Identifying and assessing the risks of material misstatement as they relate to the group financial statements – including building on the proposed revisions to ISA 315 (Revised) for obtaining an informed and thorough understanding of the entity and the environment in which it operates, with a focus on understanding the financial reporting

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<sup>11</sup> The IAASB discussed the issue of the scoping of group audits in its September 2016 meeting ([Agenda Item 5-C](#)), and agreed that scoping of group audits should more appropriately reflect the group auditor's assessment of the risk of material misstatement at the group financial statement level. The GATF further discussed how alternative approaches to scoping an audit engagement would work with different group structures, including consideration of how to apply a more top-down approach.

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- framework and its application to the entity, given the nature and structure of the entity's business, its business model, internal control, and regulatory environment; and
  - Responding to assessed risks of material misstatement including how the GET applies ISA 330.
  - 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, 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 GET and the component auditors.<sup>12</sup>
  - The necessary work effort of the GET in relation to the consolidation process, particularly regarding sub-consolidations.

*Issues Relevant to Group Audits that are Being Addressed in Co-ordination with Other Projects*

11. Currently, the GATF is working co-operatively with the task forces responsible for the revisions of ISQC 1, ISA 220 and ISA 315 (Revised) and providing input as proposed revisions to these standards are being progressed. Some foundational issues that are relevant to group audits and which need to be dealt with in the revisions to ISA 600 need to be first considered and addressed in these other projects, i.e., such that the GATF can appropriately build on the revised requirements and application material in making necessary revisions to ISA 600.
12. The following are examples of issues relevant to group audits that are being progressed through the revisions to ISQC1 and ISA 220:
  - Acceptance and continuance of engagements – as discussed in paragraph 5.b) and 10.
  - Communications between firms and engagement partners, between engagement partners and team members and others involved in the engagement (including between GET and component auditors).
  - Understanding and assessing the competence and capabilities of members of the engagement team and others involved in the audit engagement (including component auditors).
  - Nature, timing and extent of direction, supervision and review to drive the necessary involvement of the engagement partner in the audit, i.e., to address responsibility for

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<sup>12</sup> Including consideration of the need to communicate regarding compliance with relevant ethical requirements, e.g., as it relates to communications that may be necessary when there are instances of actual or suspected non-compliance with laws and regulations.

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managing quality at the engagement level (including as it relates to being involved in work performed by component auditors).

- Consideration of network-level activities by firms to address quality risks at the firm level, and therefore relevant when using component auditors from within the same network of firms.
13. The GATF will also be informed by the project to revise ISA 315 (Revised) and build upon any changes to requirements regarding obtaining an informed and thorough understanding of the entity and its environment as the basis for identifying and assessing risks of material misstatement. The changes being considered for ISA 315 (Revised) may have implications for planning and performing group audits, such as :
- Understanding the nature and structure of the entity, including non-controlled components or use of shared service centers;
  - Involvement of component auditors;
  - The financial reporting framework and its application to the group financial statements;
  - The identification and assessment of risks of material misstatement of the group financial statements and the appropriate manner in which to respond to such risks in order to obtain sufficient appropriate audit evidence; and
  - Internal control (including identifying and understanding relevant controls), and consideration of information technology and related risks; and implications for group audits such as consideration of group-wide controls.

#### *Interactions with the Public Company Accounting Oversight Board*

14. The GATF will continue to monitor the Public Company Accounting Oversight Board's project addressing supervision of audits involving other auditors.<sup>13</sup>

#### *Next Steps*

15. The IAASB is committed to revising ISA 600; however the IAASB has a number of priority projects on its current agenda and is managing finite staff resources and Board capacity. As explained above, a number of revisions to ISA 600 are contingent upon the foundational revisions being made to other standards. The GATF's efforts in the near term will therefore be primarily focused on further liaison with the Task Forces responsible for revisions to ISQC 1, ISA 220, and ISA 315 (Revised), i.e., providing necessary input to assist in how issues relevant to group audits are addressed in the revisions to those standards. As these projects progress, and as staff and other resources become available, the GATF will commence with revising ISA 600 to reflect revisions in the other standards, as well as on working on the other issues that need to be addressed in the revision of ISA 600.

**For more information, please visit the current status of the projects mentioned in this update:**

**ISA 600:** [www.iaasb.org/projects/group-audits-isa-600](http://www.iaasb.org/projects/group-audits-isa-600).

**ISQC1:** [www.iaasb.org/projects/quality-control-firm-level-isqc-1](http://www.iaasb.org/projects/quality-control-firm-level-isqc-1)

**ISA 220:** [www.iaasb.org/projects/quality-control-engagement-level-isa-220](http://www.iaasb.org/projects/quality-control-engagement-level-isa-220)

**ISA 315 (Revised):** [www.iaasb.org/projects/isa-315-revised](http://www.iaasb.org/projects/isa-315-revised)

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<sup>13</sup> <https://pcaobus.org/Rulemaking/Pages/Docket042.aspx>



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