

# Supplement A.5 to Agenda Item 4

## Questions 8(c) – What practical challenges may arise in implementing the risk-based approach?

### Question 8(c)

**Will the risk-based approach result in an appropriate assessment of the risks of material misstatement of the group financial statements and the design and performance of appropriate responses to those assessed risks? In particular, the IAASB is interested in views about:**

*(a) Whether the respective responsibilities of the group engagement team and component auditors are clear and appropriate?*

*(b) Whether the interactions between the group engagement team and component auditors throughout the different phases of the group audit are clear and appropriate, including sufficient involvement of the group engagement partner and group engagement team?*

**(c) What practical challenges may arise in implementing the risk-based approach?**

## Comments

### 1. Monitoring Group

#### BCBS

The EM (eg paragraph 54) and ED-600 set out many of the features of groups that give rise to practical challenges (including the complexity of group structures and operations, the range of geographical locations with potentially different laws and regulations, and languages and cultures).

Our thoughts on the practical challenges are:

The complexity of many groups (and as groups grow in scale, complexity typically increases) can make it hard to gain a comprehensive understanding of a group. This can make it difficult to identify all risks, but also to assess the magnitude of risks. For example, risks may be spread across the group in a way that hides their combined effect (eg different parts of a banking group may lend to the same counterparty or group of related counterparties, different parts of a banking group may hold equity and bonds in an entity as well as providing loan facilities), or risks may be transferred between group entities (eg it is common for banking groups to transact business in one jurisdiction but book that business to a legal entity in a different jurisdiction, or there is centralised risk management for business transacted across the group).

The diversity of groups, in particular across jurisdictions with their own legal and regulatory systems, and subject to local market and economic conditions, result in it being unlikely that the group engagement team will be able to fully understand all environmental risks in a group. This is particularly the case for certain sectors (eg banking) that are subject to extensive and detailed regulations. The group engagement team may need to make use of the expertise and local knowledge of component auditors to understand and assess the risks. This also means that the group engagement team may face a challenge when assessing the adequacy of the component auditor's work.

Where a risk of material misstatement is spread across a number of jurisdictions, no one component auditor may be suited to undertake all the procedures. This very much puts the onus on the group engagement team to identify, assess and determine the procedures that need to be undertaken, and to project manage the work, collate and evaluate the results.

Under the extant ISA 600, a component may be more closely related to a local set of financial statements upon which the component auditor gives a view. Under ED-600 this link may be broken or become more distant. As a result, the component auditor's work may lose some benefits derived from the audit work on the local financial statements – eg quality control procedures undertaken to meet the local audit requirements, which the component auditor may not implement if instructed under the new risk-based approach. We would note, however, that these are additional benefits, as the audit work on the component should nevertheless be undertaken in accordance with the relevant auditing and ethical standards applicable to the group.

The implications generally are that a risk-based approach to audits of group financial statements will be challenging or more difficult, as indicated in ED-600 paragraphs A78 and A87. We do not believe, however, that the challenges mean that a risk-based approach should not be applied. In this regard, linking ED-600 with ISA 220 is important to emphasise the group engagement team's obligations to manage the audit effectively (eg to ensure sufficient resources with the appropriate skills and competence are made available to deal with the practical challenges in undertaking a risk-based approach to the audit of group financial statements).

We also believe that ED-600 is an improvement over the extant ISA 600. ED-600 seems better suited to deal with the issues because of the changes made to deliver the objectives and approach set out in paragraphs 48 and 50 of the EM. While there might be broader coverage of the financial statements using the extant ISA 600's definition of components, this is not necessarily a risk sensitive approach and so may not identify and address adequately the risks of misstatement and result in an effective evaluation of those risks. For example:

A component is defined by reference to how management prepares financial information, which may act as an impediment to thinking about how risks sit across the group from an audit perspective, and to developing procedures to respond to those risks (see also response to Question 6)

While the auditor is required to assess the risks of material misstatement of the group financial statements (paragraph 18(b) of the extant ISA 600), there is a risk that paragraph 27 of the extant ISA 600 is interpreted that risks can only arise in a single component, or there is a risk the focus is on the component where the majority of the risks resides. As a result there may be insufficient consideration of the total risk.

Paragraph 27 of the extant ISA 600 allows an 'audit' of the financial information of the component to be undertaken for the purpose of responding to the assessed risks at the group level. There may be a tendency to default to this option as noted in paragraph 48 of the EM, because, for example, it aligns with local management's needs. This may lead to insufficient

attention being given to the risks of material misstatement to the group financial statements, as attention is diverted to matters that are not a significant risk in a group context.

Additional drafting suggestions or matters of clarity

There may also be additional measures the group engagement team can take to minimise the risks that the audit is not performed effectively, for example, to require enhanced independent quality control procedures be performed by the component auditor. It is not clear that this is captured within ED-600 paragraph 21 and the related application material.

## IFIAR

The application material in A 97 proposes three approaches to assigning audit procedures when the GET uses a CA. There is limited guidance to determine when these approaches would apply. Further guidance could better support the GET's decisions when assigning responsibility for the design of further audit procedures to the CA, including, for example, providing better linkage between A 97 and A 98 to A 101.

## IOSCO

### Fraud Risk

We believe that fraud risk assessment procedures at the component level should be strengthened. We believe the Paper could be strengthened by encouraging the group auditor to engage in fraud risk brainstorming sessions that include component audit teams, with the objective of identifying fraud risks at the component level.

While paragraph A80 provides guidance on information used to identify the risks of material misstatement of the group financial statements due to fraud, and the body of the Paper discusses communication when fraud is found, there is little emphasis on developing procedures at the component level to inform the group engagement team's overall fraud assessment.

We also note that several frauds have occurred via the consolidation process and the related adjustments. While extant ISA 600 more definitively addresses the consolidation process, we believe the Paper could be strengthened by alerting the group auditor to the heightened possibility for the occurrence of fraud during the consolidation process, and by incorporating additional references to fraud risks in the Paper.

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### Matrix Organization Structure

Where management uses a complex structure to operate the business (for example, a matrix structure in which management simultaneously operates the business using two co-existing structures such as by product line as well as by geography—see IFRS 8, Operating Segments, paragraph 10), the group auditor should factor this level of complexity into its planning. The entity structure should be specifically addressed by the Board as it finalizes the standard.

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#### Shared Service Center Considerations

Paragraph A6 states that “A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example, through the use of a shared service center. When such centralized activities are relevant to the group’s financial reporting process and audit procedures are performed at that location, the group engagement team may determine that the shared service center is a component for purposes of the group audit.”

We believe shared service centers should be viewed and assessed separately from business components in planning the group audit as the volume of transactions and the services provided can often be above and beyond traditional components as identified based on line of service or geography.

### 3. Regulators and Audit Oversight Authorities

#### CEAOB

Paragraph 38 states that for areas of higher assessed risks, including significant risks, the group engagement team shall evaluate the appropriateness of the further audit procedures determined by the component auditor. This requirement should be aligned with the provisions of paragraph 23 which include “areas of higher assessed risks of material misstatement of the group of financial statements, or where a significant risk has been identified and areas in the group financial statements that involve significant judgement.”

Additional provisions in ED 600 should also explain how ISA 330 paragraph 18, requiring the group engagement team to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, shall be considered in a group audit setting.

ED 600 should also clarify how to apply ISA 500 paragraph 10 which deals with the selection of items to obtain audit evidence in the context of a group audit. Indeed, it is unclear in ED 600:

If a significant risk at group level is identified, whether further audit procedures shall apply to all components affected by this risk or whether a sampling approach could be applied to components provided that the conditions required by ISA 530 are met at the level of the components and

When designing and performing substantive audit procedures (by component auditors and group engagement team) for each material account balance, class of transactions and disclosures, whether the group engagement team shall ensure that the remaining untested account balances, class of transactions and disclosures remain below the group performance materiality.

This aspect is particularly important when a group is composed of a several small individual components that cannot be grouped within one component for the purposes of further audit procedures to be performed and when audit procedures cannot be performed centrally.

#### CPAB

The application material A 97 proposes three approaches to assigning further audit procedures when the group engagement team uses a component auditor. There is limited guidance to determine when these approaches would apply. Additional guidance could better support the group engagement team's decisions when assigning responsibility for the design of further audit procedures to the component auditor including for example, providing better linkage between A 97 and A 98 to A 101.

## IAASA

Paragraph 38 states that for areas of higher assessed risks, including significant risks, the group engagement team shall evaluate the appropriateness of the further audit procedures determined by the component auditor. This requirement should be aligned with the provisions of paragraph 23 which include “areas of higher assessed risks of material misstatement of the group of financial statements, or where a significant risk has been identified and areas in the group financial statements that involve significant judgement.”

Additional provisions in ED 600 should also explain how paragraph 18 of ISA 330, requiring the group engagement team to design and perform substantive procedures for each material class of transactions, account balance, and disclosure, shall be considered in a group audit setting.

ED 600 should also clarify how to apply paragraph 10 of ISA 500, which deals with the selection of items to obtain audit evidence in the context of a group audit. It is unclear in ED 600:

If a significant risk at group level is identified, whether further audit procedures shall apply to all components affected by this risk or whether a sampling approach could be applied to components provided that the conditions required by ISA 530 are met at the level of the components; and

When designing and performing substantive audit procedures (by component auditors and group engagement team) for each material account balance, class of transactions and disclosures, whether the group engagement team shall ensure that the remaining untested account balances, class of transactions and disclosures remain below the group performance materiality.

This aspect is particularly important when a group is composed of a several small individual components that cannot be grouped within one component for the purposes of further audit procedures to be performed and when audit procedures cannot be performed centrally.

## IRBA

We recommend that the IAASB considers including a scoping paragraph in the requirements section of the standard, as not having this requirement may lead to inconsistencies in the application of ED-600 in practice. With the lack of clear requirements in this area, there is an increased risk of pressure from clients to create incentives for inappropriate scoping to achieve efficiencies in the group audit at the cost of quality, which would go against the intention of the standard. For example, there is a risk that the group engagement team may group entities and treat them as a homogeneous population when it is not appropriate and/or inconsistent with the facts and circumstances of the entities. We recommend that the IAASB considers the inclusion of requirements and additional application material on scoping to assist auditors and to emphasise the requirement for the group engagement team to evidence their judgments where the auditor's view of the components is different from that of management; and the consequential impact of this on the auditor's i) risk assessment; ii) internal controls testing; and iii) audit approach. The requirements on scoping should be principles-based and may include content from paragraphs A86 to A90 and could be placed after paragraph 33 of ED-600. The IAASB may also consider including content on what

should be covered in a group audit risk assessment process, and possibly principles on minimum scoping required, as this would achieve a consistent approach by auditors on how to design the audit approach in responding to various risks in a group audit.

In the case where an audit has been performed on the financial statements of an entity or a business unit that is part of the group, and an auditor's report has been issued for statutory, regulatory or other reasons, and the group engagement team plans to use such work as audit evidence for the group audit, as outlined in paragraph 42 of ED-600, we suggest that the IAASB considers the following:

including that the group engagement team should evaluate the relevance of such work for group audit purposes; and

that the group engagement team should also evaluate the relevance of such work from a group audit threshold for misstatements perspective, which will include the consideration of whether the actual audit misstatements for such an audit are clearly trivial for the purposes of a group audit.

The latter explanation could also be included in the application material to the standard.

In addition, paragraph 42 of ED-600 should include reporting considerations to distinguish between a statutory audit opinion and a group audit opinion, as well as the possibility of the group engagement team needing the component auditors to perform additional procedures (also known as "top-up procedures"), over and above the statutory audit procedures, in order to use such work as audit evidence for the group audit.

As part of the group engagement team's evaluation in paragraph 42 of ED-600, the IAASB could consider including the possibility of the group engagement team requesting specific reporting from the component auditor and the need to still comply with all the requirements of ED-600, regardless of the group engagement team placing reliance on the component auditor's work for statutory, regulatory or other reasons, as evidence for the group audit. This would be in addition to paragraph 42(a)–(c).

The application material of ED-600 acknowledges that communication between the group engagement team and a component auditor may not necessarily be in writing (paragraph A108). It should be emphasised that if oral communication (i.e. via a telephone, a video conference, etc.) or other forms of communication, other than written one, were the primary form of communication, the group engagement team would be required to evidence in their audit file sufficient details to clearly demonstrate the level of their oversight, read together with paragraphs 8-11 in ISA 230.

We suggest that the IAASB elevates paragraph 44(d)–(e) for indicators of possible management bias and those deficiencies in the system of internal control identified in connection with the audit procedures performed that warrant the group engagement team's attention. The IAASB may also consider reminding the group engagement team in the application material to ED-600 of the need to consider aggregation risk in collating information from component auditors.

Regarding paragraph 49 of ED-600, taking into account the nature of a group audit and how auditors address aggregation risk, the current link in paragraph A115 of ISA 330 and paragraph 18 implies the need to test the auditor's population to below materiality. Therefore, we suggest that the IAASB considers giving guidance on how an auditor should address the group audit's remaining untested population, given the requirement in ISA 330, paragraph 18, for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material account balance, class of transactions and disclosure, as that may be helpful for the purposes of the evaluation in the context of a group audit. The possible audit response to untested balances, such as substantive analytical procedures,

should also be expanded on in the application material to ED-600. This will then clarify how the stand-back provisions of ED-600 interact with ISA 330.

## NASBA

As the IAASB is aware, many component auditors may be performing an audit of the local financial statements of a branch, subsidiary or investee to meet local laws and regulations or possibly at the request of group or local management. The scope of this audit work may be more than what is required for group audit purposes. NASBA believes it is important that this work be appropriately coordinated. If done timely, this work can contribute to the overall quality of the group audit. Even if not done timely, this work can enhance the overall understanding of the business. The IAASB should consider if it would be appropriate to provide additional guidance and application material regarding how this should be coordinated and the related communications between the group engagement team and the component auditors.

## UKFRC

Scoping a group audit and the stand back provision in ISA 315 (Revised)

We strongly support the new application material in ED-600.A86-A95 that discusses the different options available to the engagement team when determining the nature, timing and extent of further audit procedures in a group audit. We also support the new application material in ED-600.A96 in respect of the GET's considerations as to when CAs should be involved. However, the standard could be further enhanced by:

Replacing the term 'Group engagement team' in paragraphs A86-A90, with 'engagement team' will make it explicit that CAs can be involved in scoping decisions as well as performing further audit procedures. This will allow the deletion of paragraphs A98-A101.

Providing additional guidance to determine when the approaches would apply (when scoping the group audit) in the context of the scoping paragraphs A86-A95. In addition, the options in A97 in the ED are very similar to the prescriptive work effort set out in extant ISA 600 (e.g. an 'audit' of a component and 'specified procedures'). The current, limited guidance could have the unintended consequences of GETs defaulting to assigning work to CAs using the extant ISA 600 prescriptive mechanisms and undermining the risk-based approach. In finalising ED-600, we recommend removing language from the standard that might encourage engagement teams to default to extant ISA 600 mechanisms, deleting paragraph A97 and instead adopting the revisions we have suggested in respect of A86-A95 above (and those set out in our response to Question 12). We consider this a more comprehensive way of demonstrating different ways in which a CA can be involved in a group audit.

Including additional material, either in the requirements directly or the application material to address stakeholder concerns that where the financial information of an entity or business unit included in the group financial statements is material, but the GET has not identified any risks of material misstatement that are reasonably possible (and therefore for which there are no relevant assertions), that the financial information would not be subject to audit. In particular this could draw on:

ISA 330.18 requires, irrespective of the assessed risks of material misstatement, the auditor to design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

ISA 315 requires that, after identifying the classes of transactions, account balances and disclosures that are quantitatively or qualitatively material, the auditor is required to reconsider, for such classes of



transactions, account balances or disclosures, whether there could be one or more risks of material misstatement at the assertion level (i.e. the ‘stand-back requirement’).

#### Involvement of CAs

Enhancing the introduction of the standard to illustrate when the involvement of CAs is likely to be a key aspect of group audits, recognising that CAs can be, and often are, involved in all phases of a group audit engagement. This is well articulated in Appendix 1 to the standard, and the introduction should be raised to the same level. An example might be when CAs have more in-depth knowledge of a component, and as a result the GET intends to obtain the assistance of the CA to determine the nature, timing and extent of risk assessment or further audit procedures.

Distinction between work performed for the purposes of the group audit and work performed to support a separate auditor’s report (e.g. a statutory audit)

We recommend clarifying the distinction between work performed by the engagement team for the purposes of the audit of the group financial statements and work performed to support a separate auditor’s report (e.g. a statutory audit of an entity within the group). This material could be included in the introduction, the application material and/or the basis of conclusions. We are not convinced that the important distinction between these two activities is well understood, and as a result, some commentators may be conflating the removal of the prescriptive mechanisms that require the ‘audit of a significant component’ as similar to abandoning statutory audits, which is not the case.

When a statutory audit of an entity is being undertaken and that entity is also determined to be a component for the purpose of the group audit, benefits may arise in co-ordinating work effort, particularly where the work performed on account balances, transactions or disclosures for the purpose of addressing risks of material misstatement of the group financial statements is also an appropriate response to risks of material misstatement of the entity subject to a statutory audit. However, this is a matter for the CA, in communication with the GET, to determine, and should not detract from the GET’s overall responsibility to identify and assess the risks of material misstatement of the group financial statements, and to plan and perform further audit procedures to appropriately respond to those assessed risks.

## 4. National Auditing Standard Setters

### AICPA

#### Evaluating Component Auditors: In Network and Out of Network Firms

Paragraph A13 states that “[r]eferences in this ISA to the engagement team include members of the group engagement team and component auditors. The engagement team includes individuals from the group engagement team’s firm and may include individuals from a network firm, a firm that is not a network firm, or an external service provider.” In several of the application paragraphs, the proposed ISA refers to situations in which the group engagement partner’s firm and the component auditor’s firm are members of the same network and notes that the extent of work performed by the group engagement partner may be impacted by the common quality management policies or procedures, for example in paragraph A44 which states:

A44 The group engagement partner’s firm and the component auditor’s firm may be members of the same network and may be subject to common network requirements or use common networks services. When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such



network requirements, for example, those addressing professional training, or recruitment or that require the use of audit methodologies and related implementation tools.

There should not be a distinction in the overall nature and extent of the work required (in this case, evaluating whether component auditors have the appropriate competence and capabilities to perform the assigned audit procedures at the component) based on whether the component auditor is from a firm that is part of the same network that the group engagement team is from. Doing so implies that more work is needed when the firm is a non-network firm. However, guidance should be added indicating that some of the work required of the engagement team may already have been addressed at the network level. Additionally, paragraph A13 should be modified to make it clear that the reference to “a network firm” is intended to mean a network firm that is from the same network as the group engagement team.

#### Using Audit Evidence From an Audit Performed for Another Purpose

Paragraph 42 addresses matters the auditor should consider before using audit evidence from an audit performed for statutory, regulatory, or other reasons (another purpose) on the financial statements of an entity or business unit that is part of the group and for which an auditor's report has been issued. While it is appropriate for ED-600 to acknowledge that the group engagement team may use evidence from an audit performed for another purpose, we are concerned that paragraph 42 may be misapplied given that the cross-reference to paragraphs 20-22 of ED-600 implies that in order to use the audit evidence from an audit performed for another purpose the group engagement team need only comply with these requirements; it is unclear which “other relevant requirements” (as stated in paragraph 42(c)) would also be applicable.

Paragraph A103 of ED-600 states, in part, “If an audit has been performed and an auditor's report has been issued for statutory, regulatory or other reasons, the group engagement team may use audit evidence from that audit if the group engagement team is satisfied that the work is appropriate for the group engagement team's purposes.” This sentence should be moved from the application paragraph and incorporated in paragraph 42 to indicate that the group engagement team may use evidence obtained from an audit performed for another purpose only if the group engagement team is satisfied that the work is appropriate for the group engagement team's purposes. This would include procedures to determine whether an audit performed for another purpose addresses the risks identified in the audit of the group financial statements.

#### AUASB

The AUASB foresees the following practical challenges that may arise:

The AUASB notes that it may be challenging to apply a risk-based approach where it is difficult to identify risk on unusual, geographically dispersed or apparently small/dormant business units and entities. A top-down focus on risk assessment relies upon effective group financial management processes and the standard would be useful if it helped auditors identify potential weaknesses in these processes that may make it difficult to perform such a risk assessment and provide guidance on suitable responses.

In responding to the assessed risk of material misstatement, the group engagement team may decide to use one or multiple approaches to gather audit evidence. When the group engagement team uses component auditors, the engagement team may request the component auditor to design and perform further audit procedures on the entire financial information of the component. The AUASB considers that the meaning of ‘Design and perform further audit procedures on the entire financial information of the component’ is not sufficiently clear. The AUASB recommends that the IAASB clarify whether this approach is meant to be a full-scope reasonable assurance engagement.

While the AUASB supports the concept that the identification of a component is as determined by the auditor for purposes of planning and performing audit procedures and may or may not align with the group structure as viewed by management, the AUASB highlights the practical difficulty of obtaining a management representation letter (refer response to question 1). Written representations are generally requested from those responsible for the preparation of the financial report. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation. Since the identification of a component may not align with the governance structure of the entity, the AUASB recommends special considerations in relation to ISA 580 are included within the proposed ED-ISA 600.

Equity accounted investments – Refer to our response to question 7 relating to potential restrictions on access to information and people.

The auditor view of component may result in unavailability or inaccessibility of financial information disaggregated at the appropriate level for group audit purposes.

### CAASB

Our stakeholders indicated that the following challenges may arise in implementing the risk-based approach:

There may be pressure from group management to minimize work at components. Group management may question whether an audit of the entire financial information of a component is required. This could impact audit quality if the GET is pressured to “minimize work”.

The risk-based approach will require increased coordination between the GET and the CA since increased two-way communication is required to plan the group audit. When working with a CA that is outside of the firm or network, it may be challenging to achieve the level of coordination required by ED-600.

In our view, the above matters could be addressed by implementation guidance.

### CNCC-CSOEC

With regard to point c of the question, i.e. practical challenges that may arise in implementing the risk-based approach, we consider that the challenge is the relevance of the risk assessment if it is carried out only by the group engagement team. We are convinced that risk assessment also requires a bottom-up approach. Please refer to question 3. Another practical challenge is to assess whether sufficient appropriate audit evidence has been obtained to respond to the assessed risks of material misstatement of the group's financial statements. We are particularly concerned about the expected work effort on residual items that will not be covered by an audit or by further audit procedures in accordance with the provisions of ED-600. In the extant ISA 600, the residual population is subject to

analytical procedures at the group level. The ED-600 is silent on this area, we therefore recommend that the IAASB clarify this point.

### HKICPA

Meanwhile, we find the visual illustration in the Proposed ISA 600 Webinar useful in demonstrating the relationship among “group engagement team”, “engagement team” and “component auditor” in ED-600, and would suggest including it as an appendix in ED-600 or as implementation guidance.

In practice, the group auditors and component auditors do not necessarily come from the same network firm, jurisdiction or regulatory regime. In addition to issues relating to restrictions on access to information or

people, other practical difficulties in a group audit engagement might include differences in audit and quality control methodologies; challenges in assessing the component auditor's independence and ethical compliance in case it is in a different regulatory regime than that of the group engagement team. Any guidance on such practical difficulties in a group audit engagement will be useful to support the implementation of ED-600.

## IDW

In addition to the matters we address in our general response above to Question 8 and our responses to (a) and (b) above, all of which relate to our concerns about the approach in the draft being detrimental to audit quality of group audits, we also note a number of severe practical challenges that will arise in implementing the risk-based approach in the draft. Some of the practical challenges will arise from varying rotation regimes across different jurisdictions, which will invariably lead to situations in which the group engagement team will be from a different network than the component auditors.

Our general response to Question 8 notes the difficulty with which group engagement teams will seek to direct, supervise and review component auditors from different firms, or network firms, that are therefore not subject to the same quality management system applicable to the group engagement team. This applies particularly to issues related to objectives, risks, and policies and procedures related to incentives and disincentives. This issue is exacerbated when dealing with component auditors from other jurisdictions, where certain kinds of measures may not be permitted.

We also believe that seeking to apply the centralized, risk-based, top-down approach to group audits as set forth in the draft will prove to be impracticable when component auditors are not from the same firm or network as the group engagement team and therefore do not use the same quality management resources (audit methodologies, tools etc.) as component auditors. The level of granularity required for risk assessment in ISA 315 (Revised 2019) and ISA 540 (Revised) and the granular responses to risks required in ISA 540 will exacerbate the impracticability of the detailed risk-based approach in the draft. Furthermore, paragraph A83 in the draft refers to the group engagement team communicating its "preferred approach" to component auditors, which suggests that component auditors would be asked to implement parts of the audit methodology of the firm or network of the group engagement team, even though the component auditor may be from another firm or network.

The consequent level of granularity of the involvement of the group engagement team in the work of component auditors would lead to the need for communications between the group engagement team to increase by an order of magnitude, which would also likely prove to be impracticable in situations when component auditors from firms or networks other than the firm or network of the group engagement team use different methodologies and tools to communicate.

Overall, we believe that the IAASB needs to consider more closely the practical implications of implementing the draft in situations where the group engagement team and component auditors are from different firms or networks (and in particular, from different countries) with different quality management systems, different audit methodologies and different tools, because the proposals in the draft do not appear to be practicable in these situations.

## JICPA

### Further Audit Procedures

ISA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements” paragraph 33 describes audit procedures required to be performed, irrespective of the auditor’s assessment of the risks of management override of controls. We believe that it is necessary to provide practical guidance on who should undertake these procedures and to what extent (in particular, journal entry testing and procedures for management bias) in a group audit under the risk-based approach.

ED-600 paragraph 49 requires the group engagement team to evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed not only by the group engagement team themselves but also by component auditors, but we are concerned whether this is practically feasible under the risk-based approach. It is unclear how detailed the group engagement team needs to evaluate the obtained audit evidence to express an audit opinion on the group financial statements, under the proposed approach to enhance the group engagement team’s involvement in the work of the component auditors.

Others

ISA 315 (Revised 2019) “Identifying and Assessing the Risks of Material Misstatement” paragraph 36 states “for material classes of transactions, account balances or disclosures that have not been determined to be significant classes of transactions, account balances or disclosures, the auditor shall evaluate whether the auditor’s determination remains appropriate.” We believe we need practical guidance for a complex and large group audit.

We also believe that we need practical guidance for the sub-consolidation cases about how the group engagement team should be involved in the risk assessment procedures of sub-consolidated subsidiaries, what kind of responsibilities the component auditor for the sub-consolidated financial information takes, and how the component auditor works with the group engagement team.

Paragraph A104

We believe that it is inappropriate to refer to an auditor who performs a statutory audit as a “component auditor.”

## MIA

With the above changes and elimination of the concept of “significant components”, there may be a need for greater clarity to ensure sufficient component auditor involvement in performing risk assessment procedures to identify, assess and respond risks of material misstatement when the GET considers such involvement appropriate. The emphasis on the importance of having a thorough and complete understanding of the group and articulation of the responsibilities of component auditors in the standard would be helpful. Additional application materials could help to emphasise the importance of the role of the component auditor in identifying, assessing and responding to the risks of material misstatement and, working in collaboration with the GET. Paragraph A96-A101 could be enhanced to emphasise that previous insights obtained by the component auditor about the entity may assist the GET’s approach in determining the audit evidence likely to be required.

## NBA

The following practical challenges might arise:

As a starting point the group auditor might have a global picture, but in case the risk assessment changes during the audit, based on the work of component auditors will there be sufficient time and effort to respond

to those changes and make adjustments to the group audit plan and procedures to be performed? For example for paragraph 38 it is unclear how this works in practice.

Will the required information be received in time from the component auditor?

Will the work of the component auditor be of sufficient and appropriate quality? We believe that addressing sufficient and appropriate work by the component auditor should be stated more in the requirements instead of being mainly included in the application material. Furthermore, paragraph A51 is not clear what type of supervision of component auditors by the group engagement team is required.

It is unclear what the difference is between component auditors and statutory auditors and how the group audit is to be combined with a statutory audit as mentioned in paragraph A55?

From paragraph 44h it is not clear how reporting and clearance between component auditor and group audit team is arranged for.

Paragraphs 55 and A121: how will the component auditor be able to sign off if important information is not shared by the group?

## NZAuASB

The NZAuASB has not identified any other practical challenges that may arise in implementing the risk-based approach at this stage.

ED-600 allows the group engagement team to assign a significant portion of risk assessment and risk response stages of the audit to component auditors while clarifying that the group engagement team is responsible for such assigned work. In the NZAuASB's view, while this is clear, practical issues are likely to arise in relation to how the group engagement team:

Considers the appropriateness and sufficiency of work performed by component auditors (the higher the degree of assigned work, the greater the need for a more robust evaluation).

How, and to what extent, such evaluation and the consequent conclusions are documented.

Paragraph A126 of ED-600 provides some guidance on the matters that must be documented, but as expected (given the nature of the issue and the wide spectrum of possible circumstances) the level, extent and nature of such documentation is a matter of professional judgement. So while respective responsibilities are conceptually clear (i.e. the group engagement team is responsible for all audit matters as if they performed all of the audit themselves), it will remain a significant challenge to demonstrate the adequate level of direction, supervision and review of component auditors' work and documentation and other necessary ongoing involvement in their activities.

We further consider that ED-600 does not clearly explain the meaning of performing audit procedures on the entire financial information of the component. We note that paragraph A98 explains that the component auditor may need to consider the sufficiency and appropriateness of audit evidence obtained in performing further audit procedures with respect to the financial statements. There seems to be a lack of clarity in specifying what is the objective of assigning performance of audit procedures on "entire financial information of a component". For example, it is unclear whether ISA 600 expects the component auditor to obtain reasonable assurance that the component financial information as presented to be included in the group accounts is free from material misstatement. The NZAuASB recommends that the IAASB clarify whether this approach is meant to signify a full-scope reasonable assurance engagement.

## 5. Accounting Firms

### BDO

#### Scoping decisions

As noted in our 'Matters of significant concern' on page 2 and our introductory responses in question 8, the extant approach in ISA 600 of identifying significant components may still be an effective approach in scoping a group audit. An important factor is ensuring that such decisions are based on responding to RMMs at the group financial statement level.

One way for the IAASB to promote this concept could be to build on and promote the content captured in ED-600.A98-A101, where overall financial significance of the component may drive a group auditor to at least initially conclude it is more effective to request the component auditor to design and perform an audit on the entire component financial statements, or we may ask the component auditor to perform specific procedures based on assessed group RMMs and the need for additional audit evidence to be obtained on one or more financial statement areas.

We would also ask that additional application guidance is provided to clarify how a group engagement team can determine:

The sufficiency of its group audit scoping (building on ED-600.A85-A90); and

Whether sufficient appropriate audit evidence has been obtained to provide a basis for the group audit opinion; particularly where there are a large number of components or the group financial statements are highly disaggregated.

Adopting these recommendations may aid completeness of identified and assessed group RMMs (which ultimately helps determine the amount of work that needs to be planned to address the risks). This may also eliminate the concern that even under the new approach, the majority of group RMMs will likely reside within those components that have financial significance. Such a combined approach might also assist engagement teams, firms and jurisdictions in their adoption and implementation of a revised group audits ISA rather than causing a radical shift in approach which generates minimal perceived benefits.

#### Risk Assessment

As we noted earlier (in 8a), it is helpful to have greater alignment between ED-600 and the concepts outlined in ISA 315 (Revised). One area that we would encourage the IAASB to reconsider is provision of implementation support materials to help describe or demonstrate how the spectrum of risk concept (which is not referenced anywhere in ED-600) might apply in a group scenario (i.e., typical types of group risks that may sit somewhere along the spectrum – whether identified at component or group levels).

The emphasis on developing a greater understanding about the nature of the group, the consolidation process and also potential impact of newer ways of accounting within a group context (i.e., shared service center) or centralized activities are all welcome advances in the context of a group audit.

Some of the application and explanatory materials in ED-600 do a good job of highlighting what is different about the group audit situation; however:

The emphasis on group engagement team as being the director of all group audit activity creates an expectation that they will be able to micro-manage engagements at the component level (despite operating in completely different jurisdictions, with potential cultural, language and access barriers). It may be helpful

to provide expanded scenarios, perhaps in implementation support materials, that can explore how the group engagement team flexes their approach based on different situations.

If component auditors continue to be included within the definition of the engagement team (see our earlier response to question 1b), there may need to be more application guidance to outline how and to what extent component auditors are likely to be part of engagement team discussions. This is particularly important where component auditors are being used for different purposes (i.e., risk assessment, obtaining audit evidence or both), or component auditors are being engaged from outside the group engagement team's own network or jurisdiction. As a consequence, we would ask the IAASB to consider the challenges of communication in these types of scenarios.

The emphasis on the group engagement team having a more directive approach could also mean key risks affecting the group, but originating in a component (particularly in areas such as non-compliance with laws and regulations, ability to identify potential fraud risks), may be missed by the group engagement team without sufficient independent (and potentially better informed) input from component auditors. One way of remedying this could be to include stronger requirements for

involvement of the component auditor, especially where there is legacy knowledge from prior component entity audits, to be more involved in the risk identification and assessment phase of the group engagement planning (including, as we noted earlier, engagement team discussions).

Practically, it could lead to a less effective and efficient approach. For example, irrespective of financial significance to the group, the risk-based approach 'cuts across' all components. As a result:

Where statutory audits are taking place at the component level, notwithstanding the content outlined in ED-600.42 and helpful materials in ED-600.A104-105, the amount of group engagement team required involvement in ED-600 to direct, supervise and review may result in two de facto individual audits being performed (one performed for group audit purposes, one performed for statutory purposes).

Group engagement teams may end up placing even less reliance on other audit firms (who may currently perform component audits) due to the increased responsibilities placed on the group engagement team to perform what is in effect a standalone audit. This may be because there are fewer perceived obstacles in complying with proposed ISA 220 (Revised) if the component auditor is from the same firm as the group engagement team.

In earlier years of implementation, a wholesale move toward a risk-based approach may cause transitional issues as a result of group engagement teams having to continue to build-up their detailed knowledge of risks at the component level (in place of component auditors who may have had a more in-depth understanding of component level risks due to performance of a full audit). This could affect audit quality - resulting in less work being planned and performed in certain areas of the group than should have been the case.

One of the biggest practical challenges is likely to be the change in mindset required of group engagement teams (and also on the part of component auditors who will need to understand 'why' the group engagement team is making different or direct demands once ED-600 becomes effective) as they move from financially-driven to risk-based requirements. Specifically:

The removal of financial significance as a determinant of a specific response (i.e., an audit of a significant component) may lead to some group engagement teams not knowing how/where to start with respect to initial scoping decisions.



Although no field testing has been planned by the IAASB, we would ask the Board continue to engage with firms, of different types, sizes and structures, to establish the mindset and scoping decision issues that both group and component auditors are likely to struggle with during initial implementation. Sharing these types of insights may also support firms as they start to amend methodologies, audit tools and training materials to support implementation.

Given the change in required mindset, the IAASB will need to think through how implementation support materials can be developed to aid both group engagement and component auditors as they adopt and implement ED-600. For example, although ED-600 highlights the importance of two-way communication, in those situations where group and component auditors are based in different jurisdictions (i.e., using different languages, cultures) or are located in other firms (i.e., applying different methodologies, tools and techniques) the move away from financial significance to a wholly risk-based approach is likely to require a more concerted level of communication by the group engagement team with component auditors. Additional implementation support materials should be developed to alert group engagement teams that the nature, extent and timing of communications is likely to require increased planning, time and application in order to fully enable the group engagement team to direct, supervise and review the work of component auditors.

## CG

Practical challenges could include:

The group auditor being able to determine whether they have done enough work and obtained sufficient appropriate audit evidence to support the opinion on the group financial statements. This arguably is an implementation challenge, and could be the subject of case studies in the Implementation Guidance; and

Ensuring robust timely two-way communication about the risk assess between group auditors and component auditors as component auditors may possess knowledge that the group auditor is not aware of. Again, a case study in the Implementation Guidance could draw attention to the importance of two-way communication.

9. Do you support the additional application material on the commonality of controls

## CR

Overall, we are supportive of a risk-based approach and believe it is consistent with ISA-315 and other relevant standards. We believe in some circumstances, in part due to the confusion in extant ISA 600, practitioners may not properly implement ED-600. We recommend extensive implementation guidance be developed and released in advance of the effective date.

## DTT

Paragraph 37 and the related application material

DTTL noted that in instances where the group engagement team has requested the component auditor to design and perform further audit procedures on the entire financial information of the component, paragraph A98 of ED-600 provides guidance that the component auditor may need to consider the sufficiency and appropriateness of audit evidence obtained. It is not clear what specific action is intended of the component auditor to address this guidance as the objective of a component auditor when performing work at the request of the group engagement team is to obtain sufficient appropriate audit evidence. DTTL recommends that the last sentence of paragraph A98 of ED-600 be deleted.

## Paragraph 42

DTTL believes that paragraph 42 of ED-600 may be misconstrued in terms of when it is applicable in the context of a group audit engagement. The specific cross-reference to paragraphs 20-22 of ED-600 may imply that in order to use the audit evidence the group engagement team need only comply with these requirements; it is unclear which “other relevant requirements” (as stated in paragraph 42(c)) would also be applicable. Additionally, as currently drafted, DTTL believes that the lack of a framework for determining when use of evidence from an audit that has already been performed is unclear (e.g., in an extreme circumstance, a group engagement team could simply postpone issuance of an audit report until all the statutory audits of a group were completed, and then apply paragraph 42 of ED-600 to obtain audit evidence for the group audit). DTTL recommends that the paragraph be clarified to provide a framework for when it is appropriate to use this paragraph.

## ETY

(c) Professional confidentiality requirements can limit interaction between the group engagement team and the component auditors

## GT

Concentration of firms able to perform group audits – As we have noted in a number of our responses above, certain of the proposals in ED-600 are making it increasingly difficult for component auditors from a firm other than the group engagement team’s network of firms to be used. The consequence of this will be that group audit engagement will increasingly be performed only by the larger firms and such a concentration of the market is not in the public interest.

We have identified the following practical challenges in applying the proposals in ED-600:

Use of component auditors – the nature, timing and extent of involvement of the component auditor in the risk assessment process and the communications to the component auditor in that respect. Increased effort will be required at the planning stage of the audit, which may not always reap the benefit of a higher-quality audit.

Use of component auditors from a different network firm to that of the group engagement team – in circumstances where the group engagement team is using a firm from outside its network of firms, the new risk-based approach makes it increasingly more difficult to perform an effective and efficient audit due to differences between the audit methodologies of the respective firms.

Risk assessment process – achieving the appropriate level of disaggregation of the financial statement line items to identify and assess the risks, as they pertain to the components, may often require the involvement of the component auditor, the manner in which ED-600 is currently drafted makes the manner in, and extent to, which the component auditor is used in the risk assessment process unclear. In this respect, we refer you to our comment above relating to the use of firms outside of the group engagement team’s network and the respective audit methodologies.

Risk assessment process – achieving the appropriate level of ‘coverage’ across the financial statement line items requires the application of professional judgment to determine when sufficient appropriate audit evidence has been obtained in totality to support the group audit opinion. Whilst engagement teams are familiar with how to exercise this judgement under extant ISA 600, guidance or a framework of how to make this judgment under ED-600 would be helpful. In this respect, we refer you to our comment above on the application of paragraph 18 of ISA 330 in a group audit engagement.

Duplicative work effort – where the component auditor is engaged to perform an audit for local purposes, but the work is not used in support of the group audit opinion or is precluded from being used by the proposed standard, audit procedures that are duplicative will be performed. This, in turn, increases the overall cost of the audit for the group and its subsidiaries without an associated improvement in quality.

Loss of local knowledge – If the group risk assessment is performed entirely, or largely, by the group engagement team, local knowledge of the component auditor that may not be known by the group engagement team may be lost and not taken into account in assessing the risks of material misstatement to the group; resulting in an inappropriate or incorrect risk assessment and inappropriate or inadequate audit procedures being performed in

### KPMG

As we describe above, we believe that the new “top-down” and centralised approach to a group audit, as drafted, may create challenges such as significant pressure on reporting timelines especially for large/ complex groups with many heterogeneous components. Furthermore, there may be particular challenges when component auditors are from another network and therefore the highly iterative nature of performance of procedures, involving multiple issuance/ updating of component auditor instructions, which would be necessary in order to implement the new approach, may be more difficult.

We also note that the revised approach, as drafted, may create practical difficulties for group engagement teams, in certain cases, in providing clear, upfront instruction to component auditors, regarding the intended nature, timing and extent of their involvement in the group audit, when the group audit will be a highly iterative process, with the scope of work intended to develop more gradually and continually evolve as the audit progresses. Consequently, there may be equivalent difficulties for component auditors to be able to understand the intended nature of their involvement and therefore to accept this at the start of the engagement, and to be able to plan and allocate resource to such engagements. This may have a significant impact, in particular, on component auditors located in jurisdictions where “referred work” forms a majority of the business model.

### MAZ

As there is no notion of coverage anymore, but only the requirement of determining further audit procedures (Tests of controls/Substantive testing) to address the risks or material misstatements, the standard should clarify if it means that there is an underlying requirement to audit non-significant elements of the financial statements and to let no residual items unaudited. In extant ISA 600, the residual population not covered by audit nor by further audit procedures were subject to analytical procedures at group level. The lack of guidance leaves open the never-ending question whether enough audit evidence have been obtained.

As mentioned in our cover letter, in terms of practicability, the key question is about the sufficiency of the work effort to be done by the group auditor on the work done by the component auditor and on the non-significant items of the financial statements. As the concept of “analytical procedures performed at group level” to address the non-significant components has disappeared, we understand that additional substantive work effort is expected. We believe that, in practice, it will be difficult for Group auditors to set expectations for non-significant components to support standards compliant substantive analytical procedures. Therefore, the consequence could be that the group auditor scopes in non-significant components and requests substantive procedures, beyond substantive analytical procedures, which would increase the work effort and cost of the audit, but not necessarily enhance the audit quality.

As mentioned in our cover letter, the standard is called “Special considerations – Audits of group financial statements (including the work of component auditors)” and is part of the series 600 in the ISA which is called “using the work of another auditor”. Moving from a component audit approach to a more “centralized” approach where more work is planned and performed by the group engagement team, could potentially lead to duplicate work and quality issues in the statutory audits at the component level. If a large proportion of the work is performed by the group auditor with the view toward having an efficient group audit, there could be challenges associated with sharing the obtained audit evidence with the component auditor (who act as statutory auditors in many cases). In groups with regional Shared Services Centers it can be difficult for the component auditor to obtain audit evidence at the component level. As of today, in practice, when the component auditor as statutory auditor wants to be sure that he will get the adequate audit evidence gathered by the group auditor or by the auditor of the Shared Services Centers or want to make sure that the materiality used of substantive work will be relevant for its statutory audit, the component auditor should send “reversed instructions” which makes the process more complicated. It would be helpful if IAASB could elaborate on how audit evidence could be shared between the group auditor and the statutory auditor.

As the revision of the standard is made to improve audit quality and consistency, we also believe that it should include that one of the key drivers for audit quality is to prepare more direct instructions. For key audit areas, including specific risks, such instructions might be in the form of work programs that set out the nature, timing, and extent of procedures. Such instructions would improve consistency of the work performed by the various component auditors and should lead to improved audit quality and a greater ability of the group auditors to gain comfort with the sufficiency of the procedures performed by the component auditors.

In discussing the “risk based approach for a group audit engagement” in the explanatory memorandum, consideration is noted to be given to “what, how and by whom and where, work is to be performed, in order to obtain the audit evidence required based on the group engagement team’s assessment of the risk of material misstatement. Implicit in that decision is the allocation of responsibilities between the group engagement team and the component auditors. Effective implementation of this ‘shared responsibility’ would be supported by more explicit guidance around the application of ISA 315 and ISA 330 to group audits. Such guidance could should address the identification and determinations as to the involvement of component auditors. In addition, further guidance regarding the response to identified risks and significant classes of transactions or accounts should lead to more effective planning and ultimately improved audit quality. Such guidance could address scoping the extent of procedures and components to apply the procedure to in order to obtain sufficient audit evidence to address the risk of material misstatement. Proper scoping would also support the analysis of aggregation risk upon completion of testing.

## MAZUSA

Response: In discussing the “risk based approach for a group audit engagement” in the explanatory memorandum, consideration is noted to be given to “what, how and by whom and where, work is to be performed”, in order to obtain the audit evidence required based on the group engagement team’s assessment of the risk of material misstatement. Implicit in that decision is the allocation of responsibilities between the group engagement team and the component auditors. Effective implementation of this ‘shared responsibility’ would be supported by more explicit guidance around the application of ISA 315 and ISA 330 to group audits. Such guidance should address the identification and determinations as to the involvement of component auditors. In addition, further guidance regarding the response to identified risks and significant classes of transactions or accounts should lead to more effective planning and ultimately

improved audit quality. Guidance similar to the “multi-location engagements” guidance in PCAOB’s Auditing Standard 2101, Audit Planning, could assist auditors in scoping their engagements.

## NEXIA

The practical challenge comes in with the application of IFRS 10 for consolidation, where the definition of “control” is applied to determine whether an entity should be consolidated. Control may be established without the “parent” having majority ownership of the entity being consolidated. This may pose challenges, especially where such an entity is not required to be audited under the local laws and regulations.

## SOUTH AFRICA

## SINGAPORE

Overall, we are supportive of a risk-based approach and believe it is consistent with ISA-315 and other relevant standards. We believe in some circumstances, in part due to the confusion in extant ISA 600, practitioners may not properly implement ED-600. We recommend extensive implementation guidance be developed and released in advance of the effective date.

## United States 2

## HONG KONG

c) Some practical challenges which may arise include:

- Collaboration from group management since group engagement team may require more involvement from them
- Level of control at head office level. It may be difficult to secure the co-operation of component management, and even if there’s good co-operation, the process could take a lot longer so there may be concerns on meeting the regulatory deadline for each jurisdiction.

Non-controlled entities, Investment carried at cost

- According to paragraph 14 of ED600 (Revised) Explanatory Memorandum (EM), the scope of ED600 (Revised) includes “non-controlled entities, including equity-accounted investees and investments carried at cost”.
- In ED600(Revised) paragraph 11(a), “consolidation process” refers to recognition and measurement by way of “consolidation, proportionate consolidation, or equity methods of accounting”.
- It appears that there is misalignment on “investments carried at cost” between EM paragraph 14 and ED600 (Revised) paragraph 11(a).

## PKF

Although a large amount of effort and care has gone into revising the requirements of ED-600, this does represent a significant change in the way group audits are performed. Identifying significant components, either by virtue of financial value or risk has become ingrained and synonymous with group audits. We foresee, in summary, the following practical challenges for implementing the requirements of ED-600:

ED-600 does not contemplate the situation whereby the group engagement team and the component team adopt a collaborative approach to performing the assessment of the risks of material misstatement of the group financial statements. Rather, ED-600 appears to assume that where a component auditor is involved in the group audit, that the relationship with the group engagement team will also take the form of one under

which the group engagement team assigns aspects of the risk assessment process to the component team. In practice, a majority of group audits will be structured in this way whereby tasks are assigned to the component auditor by the group engagement team rather than adopting a more collaborative approach. Given the recent developments in collaborative technologies, we believe that ED-600 could go further in encouraging a more collaborative, and joined-up, approach between the group engagement team and the component auditor including in the risk assessment phase and in designing the appropriate audit responses.

Group engagement teams continue to rely on statutory audits done at a component based on legal structure, resulting in group risk assessment being driven by the component auditors risk assessment as opposed to a collaborative approach. We recommend that the taskforce consider adding, to the application guidance, that the group engagement partner

## PwC

### Other audits (paragraph 42)

We believe that paragraph 42 and its associated application material may be viewed as directly undermining the intended objectives of the revised requirements for the group engagement team to take responsibility for the identification and assessment of risks, and the design of further audit procedures. As drafted, this appears to allow a group engagement team to use the statutory audits of components as providing the evidence needed over that component's financial information without the involvement in the risk assessment and design of responses that the changes were designed to achieve.

We agree that there will be certain circumstances where use of such audit work is a necessity, such as large conglomerates where there may be hundreds of (what today are described as) non-significant components, or equity method investees where the group engagement team cannot "direct" the component auditor. When, after appropriate risk assessment procedures, a determination has been made that the risks of material misstatement of the group financial statements are low in relation to such entities or business units, it may be appropriate to use evidence from such statutory audits as providing additional evidence, where this provides additional coverage and helps address aggregation risk. Such an approach would not seem appropriate for entities or business units where there are higher assessed risks of material misstatement of the group financial statements (or "significant components" as defined in extant ISA 600).

We also note that, with increasing mandatory firm rotation in many jurisdictions, the statutory auditor of a component may not be from the same network as the group auditor. The ability to obtain access to audit evidence from those statutory audits may therefore be restricted and/or the evidence obtained insufficient due to differences in policies and procedures and methodologies of the respective firms. These factors will therefore impact the ability of the group engagement team to make use of the statutory auditors' work.

We believe paragraph 42 and related application material need to be revisited to make clear the circumstances when the use of such evidence is considered appropriate, and to ensure the intent of this paragraph is aligned with the stated public interest objectives.

## RSM

We believe that the risk-based approach will strengthen the identification, assessment, and response to risks of material misstatement and improve audit quality. Group auditors will focus on the risks at the group level and audit procedures performed by component auditors will, in turn, also be more focussed on responding to those risks.



One significant challenge could be the inter-relationship between audit procedures performed by component auditors on instruction of the group auditor and the audit work required to support a local opinion by the component auditor. The group auditor may request the component auditor to perform work that, in the opinion of the component auditor is not required for the local audit opinion.

Examples could be:

the request to perform tests of controls for the group auditor in a situation where the component auditor's approach is wholly substantive.

Differing financial reporting frameworks causing differences in the approach to auditing a particular balance. For example, a group may revalue certain assets therefore there is no need to test for impairment whereas the component may carry the assets at depreciated historical cost with a consequent need for impairment testing.

A further challenge could be related to the removal of the concept of a "significant component". The risk management policies in some methodologies require concurring partner reviews or Engagement Quality Control Reviews of significant components of listed entities or PIEs. Under ED-600, networks will need to review this policy in conjunction with ISA 220 (Revised) and ISQM2 once they are finalised and determine how their risk management objectives are to be met.

Additional implementation guidance will be helpful as auditors update their methodologies and procedures from a 'significant component' focus to a risk-based approach. This may be particularly difficult when the 'auditor view' and 'management view' of the structure of the entity differs.

## 6. Public Sector Organizations

### AGA

One practical challenge for the group audit team is how do they receive and respond to "the results of the monitoring and remediation process or external inspections with respect to the component auditor's firm." For example, PCAOB releases their inspection results approximately 18 months following the period reviewed. The PCAOB reports frequently include findings of deficiencies. In 2018, the large firms ranged from an 11.5% (6/52) Part I.A deficiency rate, to a 36.5% (19/52) Part I.A deficiency rate. It is not clear how a group auditor would respond to these deficiency rates.

### AGC

Audit of financial statements of an entity or business unit may be issued for statutory or other reasons. The group engagement team may have used those audited financial statements in past years. Now that the focus is on risk instead of significant components, there might be audited information that won't be relevant for the group audit. These situations may create audit costs for entities that continue to perform statutory audits believed to be relevant for the group audit.

### AGM

We are in favour of the risk-based approach. Indeed, this approach leaves more room to judgment and theoretically should allow to design and implement more adapted responses.

However, since this approach we leave more flexibility, two accounting firms involved in a group audit could have different risk assessments. In practice, accounting firms will have to put in place mechanisms allowing



them to adjust and solve differences of opinion. We suggest adding application material that would give examples of good practices.

Moreover, we are concerned by the fact that some auditors with a greater tolerance to risks could do less audit procedures in situations where required.

## AGSA

Where component auditors are used, the timing of the audit performed by the group auditors and component auditors may differ as a result of different reporting timelines for the group and the component entity. More guidance in this regard should be included.

## PAS

(c) We are pleased to see paragraphs 31 and 51 of the proposed standard clearly make the group auditor responsible for the assessment of risks of material misstatement in the group financial statements and for determining audit procedures to reduce the risk to an acceptable level (including use of the work of component auditors). We further note paragraph 51 of the proposed standard contemplates situations where the group auditor will need to do additional procedures at the component or ask the component auditor to complete additional work.

Nevertheless, because the proposed standard remains silent with respect the component auditor's responsibility for co-operating with the group auditor, we anticipate, from time-to-time, differing views between the group auditor and the component auditor about the assessment and the determination of required audit procedures may occur. Differing views may result in the component auditor not (in the group auditor's opinion) doing sufficient work or denying the group auditor access to component audit files. This can result in inefficiencies and incurring additional audit costs—matters negatively viewed by management and audit committees. Co-operation is needed by both parties to ensure the group auditor's risk has been reduced to an acceptably low level, and to avoid inefficiencies.

## 7. Member Bodies and Other Professional Organizations

### AE

ED-600 rightly focuses on special considerations in audits of group financial statements, but its revision could have implications on the statutory audit at the component level. Moving from a component audit approach to a more risk-based approach, where more work is planned and performed by the group engagement team, could potentially lead to duplicate work and quality issues in the statutory audits at the component level as well. If a large proportion of the work is performed by the group auditor with the view to have an efficient group audit, there could be challenges associated with sharing the obtained audit evidence with the component auditor (statutory auditor). In multinational groups with regional shared service centers and competency centers it can be difficult to obtain audit evidence at the component level. It would be helpful if the IAASB could consider this issue further and address it in a separate standard or guidance.

Finally, as emphasised in our cover letter, this approach might have the counterproductive effect of discouraging the involvement of component auditors, especially when they are not in the same network. We fear that this could have implications on the audit market and the level of competition in some countries in Europe. The significance of this risk very much depends on the jurisdiction and on the complexity of group audits that are considered.

## BICA

A general challenge with a risk-based approach is lack of uniformity. While one auditor may determine a component based on certain criteria, another auditor may use a different approach to determine components in the group. This will lead to variation in reporting of a single entity and therefore lack of consistency.

General response:

The risk-based approach adopted by the proposed standard is appropriate as it provides the group engagement partner and/or group engagement team with an opportunity to evaluate each engagement on its own merits without being prescriptive. This will allow effective assessment of risks of material misstatements in group as well as appropriate design and performance of appropriate responses to the risks.

## CAANZ-ACCA

These concerns are further substantiated by the concerns mentioned in our answer to question 1 and we therefore believe the IAASB should carefully consider how to address them. We do note that these issues are more important now than ever, where audit reform reviews are happening around the world focusing on quality of audits and healthy competition in the audit profession.

## CalCPA

Given that every audit utilizes a risk-based approach, we do not believe that there are any additional challenges than those that are already known. More specifically, a risk-based audit involves significant evaluation of control systems and procedures, targeted substantive testing and so forth. Developing an understanding, communicating and coordinating, at both the group and component audit level, a common strategy for evaluating and testing common and local controls, is expected to be a practical challenge.

## CAQ

The Board highlights its view of how the risk-based approach to a group audit can be characterized in paragraph 50 of the explanatory memorandum. Such discussion includes the judgments about how, by whom and where audit procedures will be performed to obtain audit evidence based on the group engagement team's view of the group structure. It would be helpful to explain the interaction among paragraphs 31, 33 and 49 and to provide additional guidance to give further emphasis to scoping a group audit. We would suggest the guidance include explanations of how the group engagement team establishes an overall group audit strategy in accordance with ISA 300, Planning an audit of financial statements, which includes the identification of components and consideration of whether to involve component auditors. Further emphasis could be given to how, based on the auditor's identification of significant classes of transactions and account balances, the auditor determines the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient appropriate audit evidence to obtain reasonable assurance about whether the group financial statements are free of material misstatement. The factors set out in paragraph 12 of the PCAOB's Auditing Standard 2101, Audit Planning, could help provide a framework for auditors in determining where audit procedures should be performed. This also could lead to more consistency in judgments in relation to aggregation risk.

## CPAA

Whilst we support the risk-based approach reflected in the ED, it places a high degree of emphasis on the group engagement team, which given the challenges of reverse scalability (as explained in answer to question 5), the group engagement team's risk assessment may need to be shared with component auditors to a greater degree as the group increases in complexity and scale. We suggest that leveraging component auditors' knowledge and insights will be critical to maintaining audit quality, particularly in large, diverse, geographically spread or complex groups. Consequently, the ED could be enhanced by highlighting the need for consideration of component auditor involvement by the group engagement team in planning and conducting the engagement, as well as effective communications with the component auditors.

Paragraph A45 proposes that the group engagement partner, when assessing and determining whether the group engagement team has appropriate competence, considers component auditors' ability to use automated tools or techniques. Further, the ED states that when component auditors are required to use "specific automated tools and techniques", the group engagement team shall underline when communicating with the component auditors, that the use of such tools and techniques needs to be compliant with the group engagement team's instructions. Such proposals may suggest that the group engagement team would prioritise engagement of those audit firms within their network to perform component auditor work, as they will be familiar with and have access to those "specific automated tools and techniques" particularly if those tools are built in-house. To prevent the intentional exclusion of nonnetwork auditors by network firms, the IAASB may wish to consider clarifying that 'specific automated tools and techniques' may encompass technological tools compatible with the specific tool or technique used by the group engagement team (including tools provided by third-party vendors), and does not necessarily need to be restricted to in-house tools of the firm of the group engagement team unless they can be made available to the component auditors.

Results from outreach to our members and other key stakeholders indicate the increasing availability of third-party technological tools, which can be used in place of a group engagement team firm's in-house IT tools, can facilitate the engagement of non-network audit firms. Thus, audit firms performing component auditor tasks, whether as network or non-network firms, should be able to meet the group engagement team's expectations if the technological tools are provided by third-party vendors or if in-house tools are made available. See also our comments in (a) above.

## ECA

There are no special considerations in this field different from the risk-based approach in any other audit. Some experts were of the view that when no component auditors are involved, lack of comprehensive understanding of the environment, in which components are functioning, by the group engagement team could lead to the understatement of the aggregation risk.

## EFAA

We are concerned that the GET may incorrectly conclude it can perform a group audit effectively without involving component auditors and consequently audit quality is impaired.

We foresee various practical challenges. First, if the risk assessment changes during the audit, as a result of the work of component auditors, will there be sufficient time and resource to adequately respond to these changes and make appropriate adjustments to the group audit plan and procedures to be performed. Second, will the required information be received in time from the component auditor. Third, will the work of the component auditor be of sufficient and appropriate quality: it might be better to elevate some of the application material related to ensuring sufficient and appropriate work by the component auditor to

requirements. Fourth, it is not clear what the difference is between component auditors and statutory auditors and how the group audit is to be combined with a statutory audit. Fifth, it is not clear how reporting and clearance between component auditor and group audit team is arranged. And finally, how will the component auditor be able to sign off if important information is not shared by the group.

### IBRACON

Main issue is the emphasis on group engagement team as being responsible for directing all audit activity, which creates an expectation that they will be able to manage engagements at the component level, regardless the existence of some barriers as language or jurisdiction. This also can lead to less reliance on other audit firms by the group auditor, due to these increased responsibilities (also in connection with the changes proposed by ISA 220 (Revised)). Other practical impediment that could result in ED-600 not having the desired outcome is how the concept of spectrum of risk applies in a group scenario, particularly when identified in the component level.

### ICAEW

Where component auditors are involved in the audit of the group financial statements, there will be practical implementation challenges for the group engagement team in implementing ED-600. These relate to how they approach the risk assessment and the extent, nature and timing of communications with component auditors and will affect all aspects of the audit process. Significant effort will be needed at the planning stage of the audit and this needs to be clearly communicated in implementation support materials.

The responsibilities relating to client acceptance in ED-600 appear to be rather circular which might lead to confusion when trying to decide at what stage the group engagement team should involve component auditors. For instance, ED-600.13 requires the group engagement team to obtain sufficient understanding of the group to identify components and decide whether to involve component auditors. The related application guidance gives a number of ways this might be done. However, as A24 says, there may be cultural or translation issues in doing this for some parts of the group. The most logical way to resolve this might therefore be to talk to the component auditors at this stage, even if the group engagement team is not going to involve them in all of the subsequent audit.

### ICPAS

In response to 8. (c) we believe challenges could arise in implementing the risk-based approach due to differing audit methodologies between the group and component auditors. We believe the proposed standard could be difficult to implement for firms of different sizes and differing audit methodologies. In certain situations, the group auditor is a large international firm and the component auditors are comprised of teams from the group auditor's various offices. As a result, the audit methodologies are consistent between the group and component auditors. However, in other situations the group auditor is a different firm than the component auditor, with each having differing audit methodologies. We see this as a challenge in terms of scalability of the standard and would like to see more guidance or tools on how the use of different audit methodologies by the component auditors is addressed by the group auditor (Explanatory Memorandum Section 2D Scalability Considerations #37-38; ED 600 paragraphs #3, 4, 9(b), 24, 31 and 33).

We request IAASB account for all audit firms when considering the comments received and incorporating them into the exposure draft. We believe some of the standard is written to focus only on the largest firms, which puts smaller firms at a competitive disadvantage. The ED's definition of a component auditor makes the component auditor part of the engagement team. The ED references how the component auditor may

review other documentation which the firm may not be able to provide to an external party like a group engagement team. The ED factors in only group engagement teams using component auditors that are part of their network of firms rather than any outside component auditor, including those who may be better suited to provide the services. Many firms routinely perform niche audit work for foreign accounting firms that might be impacted by group audit considerations. As the standards continue to consider quality, it is important to not stifle competition, as competition will increase quality within the industry.

## IIA

Any changes in standards related to risk-based approaches may be misinterpreted and result in unintended consequences, including more risks being identified as high and, thus, increasing the cost of an audit engagement.

## IMCP

Maintain proper communication and use of the language. Lack of communication by the component regarding qualitative risks not analyzed by the Group auditor

Global diversification of the Group operations

Change how quantitative and qualitative risks are identified (Country risk and internal regulation)

How the Firm's audit methodology would be modified as well as training needed for all auditors involved in group audits. Also, technological resources may need to be aligned with the standard to comply with requirements and guidance

How the fees are allocated to the components

## INCP

Answer: The appropriate coordination between the group auditor and the component auditor because the group audit must deploy and reconcile the entire risk-based strategy to its components and that they conduct their audits in the same direction.

## IPA

The application guidance at A113 relating to the review of component auditor's work papers is insufficient as it lacks specificity.

The following issues are challenges to the proposed risk-based approach:

Over reliance on centralised controls and processes by the auditor, resulting in reduced or no audit procedures carried out the component level particularly when there are significant non-centralised systems and processes e.g. sales, inventory control etc

Over reliance on group management for representation and explanation of component results

Rather than an audit centric model the auditor adopts the management/legal structure when determining audit components

A reliance on management's assessment of component risk

The failure to adequately determine the extent of the group e.g. the failure to include in the group structured entities

Insufficient understanding of the individual components systems and how they interface with centralised systems including general ledgers, and

Control knowledge concentrated on group systems, with little or no consideration controls implemented at the component level.

## ISCA

### Practical challenges

While we support the rationale of adopting a risk-based approach, we foresee the following challenges:

If the assessed risk is not aligned by legal entities or business units, it may not be straightforward to coordinate audit efforts across the group and this would need the support and involvement of group management. GETs may face difficulty communicating the benefits of this revised approach to group management who are used to the existing approach of segregating the components by legal entities or business units.

The risk-based approach may be challenging to implement, especially for large and complex groups with many heterogenous components. As mentioned above, a group audit is a highly iterative process and the scope of work can develop gradually and continue to evolve as the audit progresses, resulting in practical difficulties for GETs to provide clear, upfront instructions to component auditors regarding the intended nature, timing and extent of their involvement in the group audit. There could be a possibility that new risks arising in those components might not be identified until a later stage. When the GET identify such risks during the consolidation stage, the GET will need to request for the component auditor to perform additional procedures, creating significant pressures on reporting timelines. This might not be a feasible approach for audits of publicly listed groups which have tight timelines. To avoid this risk, GETs might revert to the existing approach of requiring component auditors to report on all areas based on the assigned materiality. Also, as mentioned above, if the component auditor is not from the same network, it may not be possible to implement such close and continuous liaison to implement the new approach may not be practical.

## KICPA

The extant approach identifies what is financially important in group financial statements as significant, thereby being able to decrease the total risks via communications with component auditors who have a high level of understanding on components. Based on the revised ISAs, in case the group auditor, who has, anyway, a certain level of limit in their understanding on components, performs risk assessments at a group financial statements level from the stage of audit planning, however, the group auditor is likely to fail to identify the characteristics of subsidiaries and risks of the respective ones, especially when the group audit is big-sized, complex, consolidating dozens or hundreds of subsidiaries. As a result, the group auditor has a difficulty with providing clarified and specified instructions on audit procedures and component auditors have to communicate anomalies of subsidiaries at the occurrence them, thereby creating a possibility of changes in the scope of work demanded by the group engagement team to component auditors accordingly, which is expected to cause difficulties on component auditors' development of the component audit plans and performance of audit engagements.

Then, component auditors also have a difficulty in coming up with necessary plans in advance. Give such difficulties, we believe, the newly adopted audit methodology provide clarified guidance as to how the risk-based approach could specifically apply at the respective phase of what, how, by whom and where, described in the paragraph 50 of ED-600. Applying the risk-based approach at the respective phase as

above and providing templates for planning group audits and examples of how to implement them, along with examples of how the approach is exceptionally applicable to less-complex small entities, would be helpful in implementation.

## NRF

In principle we believe that a risk-based approach to group audits should result in appropriate risk assessments.

However, the risk-based approach in ED-600 is combined with a more centralized and top-down way of working, including more focus on the responsibilities of the GET, especially with regard to direction, supervision and review. Even though we support the emphasis of the group auditor being more involved, we are not convinced that the suggested structure and way of working, which will require more focus and work on team performance – and not on the group audit itself – necessarily will increase audit quality.

Also, we have some concerns that ED-600, to some extent, reflects an imbalance between the advantages of using component auditors and the supervision activities related to such use, especially if component auditors are from outside the firm of the GET or that firm's network. There is a risk that the number and content of requirements and application material dealing with the supervision of components auditors might lead to a reluctance to include component auditors in the group audit. Therefore, we would encourage the IAASB to consider emphasizing the benefits of using component auditors in order to get sufficient local knowledge when planning the group audit, especially in terms of understanding the entity and its operating environment.

## NYSSCPA

Practical challenges that may arise include:

Competency of the engagement team or the engagement partner may be impaired by complacency, diversion, or another reason.

Experience of the engagement team may be lacking, i.e., insufficient to the tasks required.

Procedures may be omitted, or less effective procedures substituted, due to time constraints.

Budget pressures may generate impetus for shortcuts in procedures.

The decision process may not follow firm guidance.

Experts may not be used when needed.

Businesses may be interrupted due to unforeseen risks (e.g., pandemic-related).

## SAICA

Due to the significant change in approach, SAICA believes that some of the scoping paragraphs in the application material should be included in the main paragraphs of ED-600. In this regard, SAICA proposes that application paragraphs A86 and A87 be included after paragraph 33 of ED-600 as a separate section, 'Scoping a Group Audit'. These paragraphs are not prescriptive and will not change the tone of ED-600 in this regard. Also refer to the response to Question 12 in terms of additional guidance that can be issued by the IAASB.

In addition to the two paragraphs mentioned above, the IAASB should consider identifying any other unintended consequences of this flexible approach to ensure that the scope of audit procedures at



component level are not inappropriate, and supplementing the application paragraphs for these scenarios. Some of the possible unintended consequences include:

Inconsistencies in terms of how different firms within the same group engagement may interpret the requirements of ED-600, especially where there are conflicts in the audit methodologies. Paragraph 25 of ED-600 states, “When the group engagement team assigns the design and performance of risk assessment procedures to component auditors, the group engagement team shall consider the results of those procedures in fulfilling the requirement in paragraph 32.” This paragraph, read together with other paragraphs in ED-600 such as paragraphs 37 and 38 create the impression that the component auditors may, to a large extent, direct the work performed at component level, and this potentially increases the risk of conflict and asymmetry between the group engagement team and component auditor's firm methodologies.

Lack of accountability at component level as the component auditors may only focus on executing group instructions without applying much professional judgement to other aspects at the component. Therefore, the group engagement team risks losing the granular details that the component auditors may communicate as per the requirements of extant ISA 600. One of the advantages of a component auditor performing an audit of a component is that they can identify the relationships between the various account balances, classes of transactions and disclosures within that component. Limiting the scope of the work to be performed by the component auditor could erode this benefit. Furthermore, there could be lack of cohesion in the work performed by the group engagement team and the component auditors where some of the account balances, classes of transactions and disclosures for a particular component are audited at the group level.

The risk-based approach could create incentives for group management to influence the group engagement team in its scoping in order to minimise the audit fee.

Uncertainty in knowing how much should be scoped in, in order to reduce audit risk to an acceptable level from a group engagement team's point of view.

SAICA is of the view that the ED-600 can be enhanced in terms of evaluating whether sufficient appropriate evidence has been obtained at group level.

Paragraph 49 of ED-600 states, “In applying ISA 330 the group engagement team shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, on which to base the group audit opinion. (Ref: Para. A115). A115 states, “The evaluation required by paragraph 49 assists the group engagement team in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in ISA 330 for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material account balance, class of transactions and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.”

SAICA suggests that paragraph 49 should be enhanced with some of the elements in A115 as follows, “In applying ISA 330 the group engagement team shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, on which to base the group audit opinion. The requirement in ISA 330 for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material account balance, class of transactions and disclosure must also be considered for

purposes of this evaluation in the context of the group financial statements. (Ref: Para. A115). Paragraph A115 could then be updated accordingly or deleted altogether.

If paragraph 49 is structured in such a way, each firm can then apply the requirement in terms of their own methodology to ensure that sufficient appropriate audit evidence has been obtained at a group level. This is in line with the principles-based approach envisaged in ED-600 and will allow flexibility in the procedures used by audit firms in obtaining sufficient appropriate audit evidence.

ISA 330.18 states, “Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure.” This paragraph read together with paragraph 49 of ED-600 implies that there is a requirement to design and perform substantive procedures for each material class of transactions, account balance and disclosure. In a group scenario, this would mean that the group engagement team needs to ensure that substantive procedures are performed until all untested balances at group level are below materiality. This could be onerous for large group engagements and could be in contradiction to the ‘stand-back’ requirement envisaged in ED-600. The IAASB needs to clarify the interaction of these two requirements. This may result in

an expansion of the scope of work beyond that anticipated and expected, especially when applying a risk-based approach.

## SMPAG

### Using Audit Evidence from an Audit Performed for Another Purpose

We also have concern with the standard with regard to paragraph 42 that deals with using audit evidence from an audit performed for another purpose. Some stakeholders believe the standard is unclear about when it would be appropriate to use audit evidence from these audits for the purpose of the group audit. For example, regarding para.42(a), how would the GET evaluate that the audit procedures performed in the statutory audit are an appropriate response to the assessed risks of material misstatement of the group financial statements? We believe this paragraph requires further analysis and understanding of the issues involved in using audit evidence from these audits.

The main concern raised is that in some cases, the GET may believe it has sufficient information and resources to perform a group audit in an effective manner without involving component auditors when this is actually not the case, such that audit quality is compromised.

Through this new approach, the work effort on a significant component may potentially be inadequate, insufficiently effective, or even mis-directed if based on inadequately informed risk identification and assessment. It is, however, unclear if such a change in work effort compared with that under extant ISA 600 will be able to satisfy audit regulators’ increasingly demanding expectations.

## TFAC

Practical challenges may arise in implementing the risk-based approach as a result of a knowledge gap between the group auditor and the component auditor when applying the risk-based approach, especially when they are from different firms. The gap knowledge may derive from the volume and complexity that have increased in business and environment such as advancement in technology, disruptive innovation, uncertainties in the geopolitical environment and also especially when there are a large number of components across multiple jurisdictions and ; in addition, the component auditors in different locations may be subject to varying cultural influences , laws or regulations or legal system, and language ,which may

affect the nature of the biases to which they are subject. Therefore; to make the risk-based approach more effective, this may require more involvement and more communication between the group auditor and the component auditor which practically may not be easy specially when there are in different locations. These factors may undermine efficient and effective identification and assessment of risks of material misstatement of group financial statements arising from consolidation process.

#### WPK

No, we disagree: see in particular sections 4, 5 and 6 above.

#### Overreliance on a Centralized Fraud Risk Assessment at Group Level

We believe that abolishing the requirement to perform full scope audits at component level (see section 2 of our comment letter) and the general bias of ED-600 towards a centralised risk assessment (see section 1 of our comment letter) is particularly problematic with regard to the “Fraud Risk Assessment”.

According to extant ISA 600, the requirement to perform full scope audits at least for all components that are significant due to their individual size (extant ISA 600.26) and the requirement for the group engagement team to be involved in the risk assessment of all significant components (i.e. both due to size and due to risk) where component auditors perform an audit engagement, establishes and safeguards a decentralized fraud risk assessment. For example, in case of an international group, audits of significant components located in other countries than the parent entity are usually performed by (local) component auditors who have detailed knowledge of the local economic and legal conditions as well as of the cultural environment, including the respective local language. In contrast to the group engagement team, they are in a much better position to perform interviews regarding sensitive issues like fraud with local management and those charged with governance or of any other appropriate counterparts within the local component under audit. Also we believe that the nature of fraud risks and the degree to which they may affect different parts of financial information under audit may differ significantly from country to country, e.g. due to economic, legal or cultural differences. Thus, local component auditors are also in a better position to perform the procedures and risk assessment considerations required under ISA 240 when conducting a full scope audit or an audit of account balances for a particular component.

Finally, the requirement of extant ISA 600.30 for the group engagement team to be involved in the local risk assessment performed for all significant components ensures that the group engagement team is made aware of any fraud risks that component auditors may have identified locally.

We believe that it is not convincing to replace the bottom-up fraud risk assessment approach required under extant ISA 600 with a centralised fraud risk assessment approach. ED-600 introduces a fraud risk assessment approach where the group engagement team is only required to perform inquiries at the group level and where it is left to the judgement of the group engagement team whether or not to perform any related fraud risk assessment procedures at component level. And even if the (core) group engagement team decides to perform local risk assessment procedures for some selected components, it is again left to the judgement of the (core) group engagement team to decide whether or not to involve any component auditors with local knowledge when performing those procedures.

#### Potential negative consequences:

ED-600 results in an inappropriate overreliance on fraud risk assessment procedures performed at group level. We believe, that requiring fraud interviews to be conducted with group management and those charged with governance at group level only, whilst leaving it to the complete judgment of the group engagement team whether or not to perform fraud related inquiries with component management or

component auditors (see ED-600 A80 last bullet point), neglects the existence of fraud risks at component level and their relevance for the group financial statements in particular in the case of a diversified, large and international group.

The reliability and the persuasiveness of the fraud risk assessment performed at the component level will be significantly reduced by scaling back or even abolishing the involvement of local component auditors in performing fraud risk assessment procedures. Similarly, replacing the entire fraud risk assessment under ISA 240 - that represents an integral and iterative part of a full scope audit performed for a component - by some individually specified risk assessment procedures also reduces the chance of identifying fraud risks that reside at a component level.

ED-600 neglects the importance of local legal and cultural peculiarities of fraud risks. We believe, it is almost ineffective, if a member of a (core) group engagement team conducts a fraud interview with component management in another country without sharing the same native language and without an appropriate understanding of relevant economic, legal and cultural differences.

Negative Competitive Effects - in particular for smaller audit firms

When developing extant ISA 600, a substantial effort was undertaken to safeguard that the group engagement team is able to use the work of component auditors regardless of whether they are members of the same audit network firm or not, in the interest of avoiding a distortion of the competition between different audit firms. We believe that extant ISA was successful in that regard and has led to a current group audit practice, where group auditors can use the results of full scope audits of components that were performed by non-network related component auditors efficiently and without any major obstacles.

An important precondition for using a full scope audit performed by non-network related component auditors is that those audits are performed compliant with the ISAs. In this regard, the use of two different firm specific audit manuals or audit methodologies by two unrelated audit firms does not represent an issue, as long as both methodologies are ISA-compliant.

Only in a few audit areas, extant ISA 600 requires the group engagement team to provide the component auditor with specific audit instructions prescribing or influencing a particular work effort at component level (in particular with regard to significant risks and component materiality). Again, receiving specific instructions regarding component materiality or group significant risks does not prevent a non-related component auditor from using his own firm specific audit methodology.

Under ED-600, however, the group engagement team may need to influence the audit approach taken by a non-network-related component auditor in a much more comprehensive and granular way. As explained in para 52 of the explanatory

memorandum, “when component auditors are involved, the group engagement team remains responsible for the identification and assessment of and responses to the risks of material misstatement of the group financial statements. The group engagement team therefore needs to direct and supervise the work performed by component auditors and review their work.” Under these circumstances, differences in audit methodologies or audit manuals used by non-network-related component auditors may represent a significant burden or even obstacle when using their work for purposes of a group audit.

Furthermore, ED-600 A83 explicitly foresees that a group engagement team “may need to communicate its preferred approach [i.e. its own audit methodology] with component auditors or provide instructions”. In other words, a group engagement team may regard it necessary to request a non-network related

component auditor to comply with major parts of its own network-specific audit manual as a precondition for using the work of such a component auditor.

Potential negative consequences:

The increased granularity of the responsibility of the group engagement team for the identification and assessment of and responses to the risks of material misstatement across all components of a group may mean that differences in audit methodologies or audit manuals used by non-network related component auditors may represent an obstacle for using their work for purposes of the group audit. Since the group engagement team will (have to) use its own audit manual as a framework for the sufficiency and appropriateness of audit evidence obtained in response to an assessed risk, this may result in a much more significant interference in the way a component auditor performs an audit than under extant ISA 600.

The increased responsibility of the group engagement team for the identification and assessment of and responses to the risks across all components also means that the granularity and the extent of information that needs to be exchanged between the (core) group engagement team and the component auditors will increase significantly. We expect, for example, that group audit instructions sent to component auditors or highlight memos prepared by component auditors will need to contain information on individual assessed assertion level risks and the nature and the results of individual audit procedures performed to a much larger extent than under extant ISA 600. Such an intensified communication between the group auditor and the component auditor can be implemented much more easily within a network than outside the network, due to differences in the software solutions used by different networks to document identified assertion level risks and the performance of further audit procedures.

This potential negative competitive effect for non-network-related component auditors becomes even more prominent when larger network firms develop their own group audit software, enabling them to push down risks identified and further audit procedures specified by the (core) group engagement team into the engagement files of network related component auditors, whilst non-network related component auditor would not be able to participate in such an efficient way of exchanging information.

We believe that the approach described in ED-600 A83, i.e. suggesting that a (core) group engagement team may request and instruct non-network related component auditors to apply major parts of the audit methodology or audit manual of the group auditor, may create an unacceptable competitive disadvantage for smaller non-network-related audit firms when acting as a component auditor.

The difficulties for using the results of the work of non-network-related component auditors (in particular of small and medium sized audit firms) that are caused by ED-600 in contrast to extant ISA 600 will have harmful repercussions for the European idea of strengthening small and medium-sized companies (including audit firms).

Lack of consideration of the practical implications of ISA 540 (Rev.) and ISA 315 (Rev. 2019) in the context of a group audit

As discussed above (see section 1 of our comment letter) ED-600 foresees a centralised risk assessment performed by the group engagement teams (top-down approach). By the time ISA 600 becomes effective (we presume at the earliest in 2 or 3 years), the risk assessment performed in an ISA-Audit will significantly change as a result of implementing ISA 540 (Rev.) and ISA 315 (Rev. 2019). We believe that ED-600 does not yet contemplate or discuss in a sufficient way the practical implications which ISA 540 (Rev.) and ISA 315 (Rev. 2019) will have in the context of a group audit, in particular for the co-operation of a (core) group engagement team with the component auditors.

## 8. Academics

### AFAANZ

Extant ISA315 paragraph A186 reinforces the requirement that inherent risk is to be assessed independent of control risk. Research suggests that auditors may struggle to deal with the interdependencies between inherent and control risk (Messier and Austin 2000; Miller et al. 2012), and this has the potential to be incrementally challenging in a group audit setting. Paragraph 31, referring to ISA315 requires the group engagement team to assess the risk of material misstatement of the group financial statements based on the understanding obtained in paragraph 24. Paragraph 24 includes both inherent risk and control risk considerations, thereby blurring the requirement, as expressed in ISA315, to identify risk of material misstatement before consideration of any related controls. We recommend that additional application and explanatory material relating to paragraph 31 be included to reinforce the expectation that risks of material misstatement are identified before consideration of any related controls. In this regard, wording similar to ISA315 paragraph A186 could be employed.

We also note, with reference to the extant literature, the challenges in recognising and responding to risks arising from quantitatively non-significant components and qualitative factors (Graham et al. 2018; Backof et al. 2020). Graham et al. (2018) suggest that statistical sampling principles can be applied to achieve additional comfort when selecting non-significant components for which audit procedures will be performed. We recommend that additional explanatory and application material relating to paragraph 33 (under scoping of a group audit – currently paragraphs A86 to A90) be included to recognise the potential for sampling (and the provisions of ISA530) to be employed in terms of scoping-in smaller non-significant components in order to manage audit risk. Backof et al. (2020) show that requiring group auditors to separately consider and document quantitative and qualitative risk factors (rather than taking a holistic approach) resulted in auditors being more sensitive to qualitative risk factors. With this in mind, we recommend that paragraph A78 be expanded to recognise that the group engagement team considers both quantitative and qualitative risk factors.

### GRAHAM

My comments apply primarily to the risk-sensitive planning of group audits and the selection of some components for auditing when all components are not subject to detailed audit procedures. I believe they relate primarily to issue GA7, Responding to Identified Risks of Material Misstatement in a Group Audit (Including Issues Relating to the Group Engagement Team's Involvement in the Consolidation Process).

An issue I have repeatedly seen in workpapers and as a consultant and advisor is that for many engagements, auditors are unable to provide any explanation of the factors they considered when setting the scope of the components to be audited in a group. Peer reviewers and inspectors challenge the auditors to support that sufficient evidence has been gathered to attain a low audit risk. Why they chose a certain number of components to apply procedures rather than more or fewer is often entirely unclear.

While in some entities, centralized management and control support an aggregate audit approach across components. There remain numerous situations where this structure does not apply. Nevertheless, some auditors incorrectly "shoehorn" their audit strategy into this mold for ease of design and performance of procedures. One issue contributing to this incorrect practice is the lack of guidance, structure and examples in the extant Standard when setting the scope on multi-component audits.

In addition, I note the current ED does discuss scoping in the A appendix section (Scoping a group audit: paragraphs A86 – A90). However, that specific guidance is limited to entities with a homogeneous controls

and operating environment across components. While this may address the current direction of many entities toward shared services and processes, it does not represent the current situation for many smaller to medium enterprises where the business model for its components may not yet be mature enough to impose a firm-wide internal control and central record-keeping process.

Since the issuance and implementation of the Group Audits Standard there have been some publications that recognize and illustrate some methods for addressing this problem. In the research and accounting literature there have been several efforts to provide some structure and guidance around the scoping of component audits. In 2008, the AICPA published an updated Audit Guide Audit Sampling. The Task Force for this guide agreed to include an Appendix illustrating a two-step process for multiple component audit planning. This suggested approach could be applied when component environments were not sufficiently homogeneous to treat them as one population, and not all significant components will be subject to auditing procedures. Now Appendix L in the latest (2019) update to that guide, the illustrated process included a decision about how many components would be examined and secondly, the scope of audit procedures to be applied at those locations to achieve a low group audit risk. Before and after this publication, the approach in the guide was applied in several large and medium size US firms. In practice, at least one firm developed an Excel template to facilitate practice use of the approach.

The need for illustrations of applying this approach for others to better understand how to operationalize the concepts was realized with the 2017 publication in the International Journal of Auditing (IJA) of a paper entitled Managing Group Audit Risk in a Multicomponent Audit Setting. A practitioner summary of that paper was subsequently published in the American Accounting Association's Current Issues in Auditing, Fall 2018. The IJA paper provided specific examples of how the approach outlined in the guide could be applied under various different assumptions regarding the characteristics of the components. A key value of the illustration of the approach in the IJA paper was the articulation of the factors involved in the scoping decision and how each of those factors contributed to the planning decisions.

In 2008 the Journal of Accountancy (US) published a practice-oriented paper entitled Component Materiality for Group Audits. The approach in this paper was to allocate group materiality to major components that would be receiving auditing procedures. It was assumed that components not receiving audit procedures were of lesser value such that analytical procedures would provide sufficient evidence. While helpful in the circumstance where a few major components comprised the entity, the more difficult problem of how many components should be selected for the application of audit procedures was not addressed. However, these two approaches are not mutually exclusive, but can be applied together.

I urge the Committee to consider for inclusion in its scoping guidance at least some of the factors and structure identified in these studies for auditor consideration when faced with planning engagements where the components cannot logically be considered as a single unit. While short of specifying a methodology for application in planning, like in Section 530 on Audit Sampling, the factors for consideration when setting a sample size (e.g., risk, tolerable misstatement, expected misstatement) help structure and document the decision.

Amongst the important factors outlined in the aforementioned papers are:

The overall assessment of organization centralization and internal control over financial reporting effectiveness of the entity. Do the individual component characteristics support their treatment as a homogeneous audit unit from the perspective of risks, controls, organizational and the centralization of accounting records, management oversight and accounting software and financial reporting policies?



Determining a logical component base or bases (e.g., assets, revenues, contribution to entity profitability) from which to plan and allocate the audit effort required. It may be appropriate to consider the relative impact on planning of several relevant bases.

The identification of components for examination that due to their size or assessed risks should clearly be selected and

have audit procedures applied. If, after the identification of these components, the number and value of the remaining locations is still significant in the aggregate, decisions regarding the number of components to be selected for applying procedures will need to be made.

The identification of trivial components for the application of limited auditing or analytical procedures.

When components are numerous and a few large components cannot be identified to comprise the entity, then selections of components and scoping decisions about the components where audit procedures will be applied may follow the general risk structure outlined in Appendix L of the 2019 AICPA Audit Guide Audit Sampling.

Factors entering into the decision about the minimum number of components to be identified for applying audit procedures may include:

The magnitude of the selected base(s) of each component

The assessed maximum misstatement of the base(s) at a component that could exist and not be detected by entity controls or other applied auditing procedures. If not able to be limited, then a conservative assumption could be that a 100% misstatement could exist.

The minimum number of components in the remaining population (after removal of the large and risky components) that would have to be misstated to the “worst case” extent to cause a group misstatement concern. This could result in the number of components necessary to select in order to detect if the “worst case” assumption might exist in the population of remaining components.

The scope of auditing procedures needed at the selected components where audit procedures are to be applied to detect existence of a possible “worst case” condition and also meet component performance materiality requirements.

The practitioner summary article in the Current Issues in Auditing article contained the following table which has been found to be helpful guidance:

As noted in paragraph A91 in the ED, an element of unpredictability remains important in fraud prevention and protection.

I would be pleased to assist the Task Force in any way in refining this suggestion to assist practice in making more effective and more consistent scoping decisions when the existence of multiple components create scoping complications.

## **Q8(c) – No Comment**

### **1. Monitoring Group**

#### **IAIS**

(c) What practical challenges may arise in implementing the risk-based approach?

### **2. Investors and Analysts**

**CRUF**

No Comment

**3. Regulators and Audit Oversight Authorities**

**CSA**

No Comment

**MAOB**

No Comment

**4. National Auditing Standard Setters**

**ICAI**

No Comment

**KSW**

No comment

**5. Accounting Firms**

**BT**

No comment

**EYG**

No comment

**MGN**

No comment

**MNP**

We have not identified any practical challenges in implementing the risk-based approach.

**6. Public Sector Organizations**

**AGO**

No comment

**GAO**

No comment

**7. Member Bodies and Other Professional Organizations**

**CPAI**

No comment

## **FAR**

In general, FAR supports the response submitted by the Nordic Federation of Public Accountants and FAR therefore refers to this response.

## **ICAS**

No comment

## **MICPA**

No comment

## **SRO AAS**

No Comment

## **8. Academics**

### **HUNTER**

We do not see challenges that may arise in implementing the risk-based approach

### **LI**

No Comment

## **9. Individuals and Others**

### **PITT**

No Comment

### **VERA**

There are no special considerations in this field different from the risk-based approach to any other audit.