

1 June 2016

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submitted electronically through the IAASB website

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## Re.: Invitation to Comment: Enhancing Audit Quality in the Public Interest

Dear Kathy,

The IDW appreciates the opportunity to comment on the above mentioned Invitation to Comment, hereinafter referred to as “the ITC”. In addition to the general comments we have provided in this letter, we have sought to address most of the questions posed in the ITC in the Appendix to this letter.

### General Comments

As the ITC points out, the environment in which ISQC 1 and ISA 600 were developed has changed. Besides developments in the way firms are seeking to enhance the quality of their services, external inspections have been introduced in many jurisdictions. Consequently, we support the IAASB’s initiative to consider quality control and the inter-related issues of professional skepticism and group audits at this time.

In our opinion, the fact that the ITC focuses heavily on whether clarifications are needed within existing standards to address shortcomings regulators have noted in practice serves to detract from what we believe the IAASB ought to view as the key issues in this project:

- In comparison to post-performance detective and corrective measures, preventive measures designed to secure the provision of high quality

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services are superior both in terms of serving the public interest (i.e., in improving the quality of service *before* it is actually provided) and also in terms of any “learning effect” for practitioners and staff involved (on-the-job action is more effective in shaping behavior going forward than a more theoretical consideration of what should have been done in a particular engagement that had been completed months or years before). We therefore believe that ISQC 1 needs to increase its focus on a firm’s proactive management of quality going forward and consequently less on controls aimed at an evaluation or inspection of services provided in the past.

- The quality of a firm’s services is heavily dependent on the quality of individuals who provide those services. If a firm does not have the right resources, and in particular the right partners and staff to provide services, it may lack the potential to improve the quality of its future services. Thus factors including staff availability; staff competence and skills; the application of support tools; availability of support services such as consultation on technical issues; direction and supervision by more senior staff and partners; as well as motivation of individuals must all be considered highly relevant to audit quality. Sound human resource management practices, including appropriate involvement of engagement partners represent a major part of the way firms can address quality improvement. Professional skepticism forms an integral part of this.
- A root cause analysis of findings by oversight authorities and internal monitoring would potentially be more effective than the addition of numerous clarifications or strengthened requirements in the IAASB’s standards, because such analysis would enable individual firms to identify which remedial actions are needed and best suited in their individual circumstances and environment (e.g., enhancing their in-house training initiatives, revision of firm or network methodology, application of new resources etc.).

Many of the concerns detailed in the ITC seem to reflect the mis- or non-application of the current standards and thus do not indicate the necessity for revision of the relevant requirements. There may be a variety of reasons underlying regulators’ findings. In so far as a lack of understanding of what is required is concerned, additional clarification or guidance may be called for. Where other factors are responsible (e.g., time pressure that limits detailed documentation) clarification may not be helpful. Indeed – read in isolation – many proposed courses of action discussed in the ITC seem to make sense.

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However, the sheer volume of potential clarification gives the impression that the IAASB is seeking to expand the ISAs significantly, which may not improve quality, but which would lead to excessively long and detailed standards potentially signaling a move away from the principles-based standards setting adopted by the IAASB to date. We caution against such a course of action, and believe that the IAASB should weigh the merits of using other mechanisms in specific instances. Certainly, IFAC member institutes and firms already struggling to keep up-to-date with changes may simply find significant increases in application and guidance material challenging to deal with. In this context, we believe the IAASB needs to be highly sensitive to this factor and limit changes to its standards to those that will actually result in a better practical application of existing requirements.

However, the underlying message seems to be that where documentation does not sufficiently demonstrate a particular course of action had been taken, it will be noted as a regulator concern. We urge the IAASB to remain sensitive to the need to ensure that auditor requirements to prepare documentation for audit quality purposes do not lead to disproportionate documentation solely for oversight purposes. With respect to each of the three major topics (professional skepticism, quality control and group audits) we have the following general comments:

### **Professional Skepticism**

- Professional skepticism is a key factor for assurance engagements and hence a hallmark of the auditing profession, which impacts the public's expectations as to the auditing profession's role.
- We agree that the IAASB should explore this aspect of the audit further in order to determine how it relates to standard setting. For example, the IAASB needs to ask itself how the auditing standards themselves may need to embody professional skepticism. Are some aspects of extant standards biased overly towards evidence gathering to the detriment of the auditor applying a questioning mind?
- Due to its nature, professional skepticism is not an issue the IAASB can explore in isolation. Education and ethical aspects also play a significant role in achieving the means so the profession is to be perceived as exercising professional skepticism in an appropriate way. Thus the IAASB will need to address this issue in conjunction with the IAESB and the IESBA.
- The impact of a particular culture on both the exercise of professional skepticism within a firm and an individual auditor's propensity to follow-

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through in practice on any findings where particular emphasis had been placed on professional skepticism are issues we suggest will need careful consideration. To some extent such consideration will be linked to the notion of fortitude as mentioned in the ITC.

- Given these issues, we suspect that the IAASB will need considerably more time and resources to be in a position to address this particular area of the ITC than the other two areas.

### Quality Control

- We note the increasing influence of audit regulators on the content of the issues addressed in the ITC. For example, in paragraph 123 reference is made to the need for safeguards to be put in place in relation to detection risk – this terminology stems from the IESBA code – ISAs use risk response in this context. The IAASB needs to be clear about the application of the risk based approach.
- In our view, there are a number of Frameworks, such as COSO ERM, Quality Management Standard ISO 9001, and OCEG, etc, that have become internationally established and provides a sound basis for consideration by the IAASB in this project. In our opinion, an approach to management of quality involving continual evaluation that leads firms to address their individual potential for improvement will be far more in line with the aims of delivering quality services than the current approach under ISQC 1 developed several years ago. Consequently, we strongly support the introduction of a quality management approach.
- A number of suggestions discussed in the ITC derive from initiatives applicable to certain parts of the audit market in an isolated number of jurisdictions (e.g., transparency reporting). We agree that it is appropriate for the IAASB to be fully aware of such developments and also for the IAASB to discuss any potential applicability to its own standard setting. However, we do not believe that this ought to result in standard setting activities at an international level.
- The IAASB also needs to bear in mind that it has a role as standard setter at an international level for all sizes of firms, from the sole practitioner auditor to the so-called Big 4 firm. On this basis we urge the IAASB to remain sensitive to this, and, in particular, to determine where additional guidance, sliding scale requirements or conditional requirements may be an appropriate way of dealing with matters applicable to only a certain part of the audit market (e.g., auditors of listed entities, SMP firms etc.). The IAASB will also need to be sensitive

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to the fact that there are very different legal environments around the world, different legal forms for firms, with different governance structures etc. In particular, initiatives that impact the management of firms, while reasonable for larger firms, may be disproportionate for many smaller firms.

- In conclusion, we support the IAASB reshaping ISQC 1 from its current control mindset to a quality management approach designed to require firms to focus on their own internal management of quality factors, using a risk based approach tailored to the individual firm's circumstances and environment, including the quality objectives arising from the engagements performed.

### **Group Audit**

- As explained above, we believe that many of the concerns detailed in the ITC seem to reflect mis- or non-application of the current standards and thus do not indicate the necessity for revision of the relevant requirements. Furthermore, we are not convinced that adding additional examples will be helpful in all cases, which would detract from a principles-based approach and may be applied in inappropriate circumstances.
- Although we agree that it makes sense for the IAASB to explicitly recognize how the requirements of ISA 600 are intended to apply in the context of the audit of "letter-box companies" and the increasing use of shared service centers, outsourcing techniques etc., we are not convinced that the volume of clarifications suggested in the ITC will be helpful. We refer to our responses to the questions posed in regard to group audits in this context.

The ITC is a very lengthy and detailed document covering broad areas relevant to the audit, which makes it heavy-going even for readers familiar with the issues addressed. The number and complexity of the questions posed, many of which include up to 8 sub-questions, means that potential respondents need to invest a heavy time commitment in order to do any justice to the issues discussed. As we have explained, this presentation may also detract from key issues.

On balance we believe that shorter, more manageable papers that deal with single topics (PS, QC, GA individually) would be better suited to soliciting views in line with the IAASB's established due process; cross-over issues could be dealt with in each of the papers.

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If you have any questions relating to our comments in this letter, we would be pleased to discuss matters further with you.

Yours truly,

Klaus-Peter Feld  
Executive Director

Wolfgang Böhm  
Director Assurance Standards,  
International Affairs

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## Appendix

### GENERAL QUESTIONS

#### G1.

***Table 1 describes what we believe are the most relevant public interest issues that should be addressed in the context of our projects on professional skepticism, quality control, and group audits. In that context:***

***a) Are these public interest issues relevant to our work on these topics?***

***Fostering an appropriately independent and challenging skeptical mindset of the auditor***

We agree that it is in the public interest for an auditor to exercise appropriate professional skepticism. However, the IAASB cannot deal fully with this on its own in this one project. The issue of how to foster professional skepticism is interrelated with education, ethics, quality control and other factors, and therefore we support the IAASB's initiative to coordinate its approach with the IESBA and the IAESB. Professional skepticism is also impacted by the culture prevalent in individual jurisdictions, which standard setters need to bear in mind when setting standards, but will not be able to change on their own.

***Enhancing documentation of the auditor's judgements***

We agree that appropriate documentation may be effective in evidencing professional skepticism applied by the auditor. The IAASB will, however, need to be careful to ensure that the project on professional skepticism is not confused with professional judgment or that the project is subject to scope creep to dealing with professional judgment in general. Professional judgment and professional skepticism are interrelated, but the project on professional skepticism is narrower than one on both. It should also be recognized that auditors need not document every thought process used to arrive at a particular judgement: only the significant judgments for significant matters need to be documented, as currently required by ISA 230, which means that further requirements are not required in this respect.



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*Keeping ISAs fit for purpose*

The ITC recognizes the importance of keeping the ISAs fit for the purpose in today's rapidly changing auditing environment. We would caution the IAASB to be careful in the way it responds to demands to strengthen its requirements, so that it continues to place sufficient emphasis on ensuring that the requirements remain principles-based so that they are capable of dealing with the rapidly changing environment. The alternative leads to ISAs becoming a cookbook, which, in turn, fosters a tick box mentality – potentially to the detriment of audit quality.

*Encouraging proactive quality management at the firm and engagement level*

We strongly support introducing proactive quality management – especially human resources management – and support a quality management approach (QMA) at firm level. This approach focuses on preventive rather than detective measures, and, as it follows the risk-based approach (that is, risk assessment and risk response) already anchored in the ISAs, would also result in solutions that can be more scalable than the current ISQC 1. We also support having the engagement partner focus on quality management for individual engagements. In practice, staff's attitude to quality is influenced by both the firm-wide stance (tone at the top) and the stance evidenced in their dealings with the engagement partner. A "strong" engagement partner can exercise a high degree of influence on the engagement team's attitude to audit quality.

*Exploring transparency and its role in audit quality*

We do not believe that the IAASB should use its resources to explore what is termed "transparency reporting" in certain jurisdictions within this standards setting project because reporting that provides transparency about a firm's quality management is a legal or regulatory issue. Reporting of this nature is not, in its own right, a direct driver of quality that should be addressed in ISQC 1 or ISAs.

However, should the IAASB wish to explore what content of such reporting might be useful, a discussion paper to illicit views on the issues involved would currently be the most appropriate course of action for the IAASB to take. If the IAASB chooses to include requirements in ISQC 1 with respect to transparency reporting and similar reports by firms, at this stage these should be limited to requiring that such reporting not contain material misstatements of fact and not be misleading, and that assertions made in such reports be supported by adequate evidence, which may cause such reports to be an indirect quality driver.



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*Focusing more on firms (including networks) and their internal and external monitoring and remediation activities*

Yes, ensuring that firms explore remediation in relation to significant findings of their internal and external monitoring will be essential if the IAASB takes a QMA seriously. However, we are not convinced that, given the wide range of types of networks (which range from those using only a common brand name without any other measures to networks with fully-integrated common policies and procedures), the IAASB will be able to provide requirements and guidance for networks. Rather, the IAASB should focus on the use by firms of policies and procedures at network level and what this implies for those firms.

*Reinforcing the need for robust communication and interaction during the audit*

Adequate communication is key throughout the audit, and so the IAASB should explore how its standards could strengthen this area.

***b) Are there other public interest issues relevant to these topics? If so, please describe them and how, in your view, they relate to the specific issues identified.***

Certain issues of which the IAASB is already aware that warrant further consideration include:

- Further clarification of the identification and assessment of risk of material misstatement (we understand that the IAASB has commenced a project to revise ISA 315).
- Further clarification of materiality and going concern; however it will be difficult for the IAASB to usefully address these issues until accounting standards setters, such as the IASB, have developed further authoritative requirements and guidance in these areas.

Auditors' considerations and work in relation to service organizations as well as data analytics are further aspects rapidly becoming more significant in practice. The IAASB may need to discuss how these developments can be addressed. With respect to data analytics, the IAASB first needs to explore exactly what the impact on the audit can and should be.

The ITC also refers to an auditor's fortitude. Professional fortitude is very important to the application of professional skepticism, in that the exercise of professional judgment using professional skepticism leads to appropriate action in adverse circumstances. In our view, firms can play a leading role in fostering

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professional fortitude amongst partners and professional staff. This is an issue that may be worthy of further consideration by the IESBA, and in particular, how professional fortitude is different from and relates to integrity, independence and objectivity.

***c) Are there actions you think others need to take, in addition to those by the IAASB, to address the public interest issues identified in your previous answers? If so, what are they and please identify who you think should act.***

We believe that “fortitude” as explained in the ITC is an issue that the IESBA ought to address. Otherwise we do not see a role for education or ethics standard setters in the areas referred to above.

As noted above, accounting standard setters, and the IASB in particular, need to develop more authoritative requirements and guidance in the areas of materiality and going concern.

**G2.**

***To assist with the development of future work plans, are there other actions (not specific to the topics of professional skepticism, quality control, and group audits) that you believe should be taken into account? If yes, what are they and how should they be prioritized?***

We refer to our responses to G1 b) and c) above. Since the matters mentioned in our responses thereto are few, we believe these to be of high priority.

**G3.**

***Are you aware of any published, planned or ongoing academic research studies that may be relevant to the three topics discussed in this consultation? If so, please provide us with relevant details.***

The following publications may be of interest:

“The Influence of Information Order Effects and Trait Professional Skepticism on Auditors’ Belief Revisions”;

- Research Article:
- Author: Kristina Yankova;
- Published 2014 Auditing and Accounting Studies by Springer Gabler;

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- ISBN 978-3-658-08870-5, ISBN 978-3-658-08871-2 (eBook)

“The Association between Audit-Partner Quality and Engagement Quality: Evidence from Financial Report Misstatement”;

- Auditing: A Journal of Practice and Theory: Vol.34 No.3
- Authors: Yanyan Wang, Lisheng Yu, Yuping Zhao
- Published 2015 American Accounting Association

## PROFESSIONAL SKEPTICISM

### PS1.

***Is your interpretation of the concept of professional skepticism consistent with how it is defined and referred to in the ISAs? If not, how could the concept be better described?***

Yes, our understanding is based on the extant definition and related application material. We note that the discussion in the ITC places significant emphasis on “challenge” per se as a part of professional skepticism, whereas ISA 200.A20 refers to questioning contradictory evidence. The IAASB needs to be careful not to increase public expectations and audit work effort in areas where such contradiction is not in evidence, (i.e. challenge for the sake of challenge) as ISA 500 already deals with the auditor’s objective to obtain sufficient appropriate audit evidence, including inconsistency in, or doubts over reliability of, audit evidence.

However, the definition could be more robust and, in particular, it should clarify that professional skepticism is an epistemic issue i.e., that it is always related to justification based on grounds or evidence.

We also believe that clarification of the relationship between professional skepticism on the one hand and objectivity, independence of mind and due care on the other hand would be helpful – especially to clarify that these ethical concepts influence professional skepticism (but not the reverse, since we note that professional skepticism is currently related to evidence and misstatements in IAASB assurance engagement standards, and therefore is not applicable to other activities of professional accountants).

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**PS2.**

**What do you believe are the drivers for, and impediments to, the appropriate application of professional skepticism? What role should we take to enhance those drivers and address those impediments? How should we prioritize the areas discussed in paragraph 37?**

In our opinion, some of the current calls for the improved application of professional skepticism may stem from the view that when inspection findings cannot be allocated to a specific violation of a requirement in a standard, insufficient skepticism had been exercised – i.e., it represents a “catch all”. Thus the scope of what may be termed “lack of professional skepticism” appears to be very broad at present.

Indeed, we suggest that it may be too early to effectively address this issue within the IAASB’s standards in a meaningful manner and would encourage the IAASB to perform more research in this area to identify exactly what professional skepticism comprises and when it would not have been applied appropriately. In this context, we believe that thorough root cause analyses would be helpful in exploring further the extent to which inspection findings indeed indicate a lack of professional skepticism.

In our view, the drivers and impediments that standard setters may influence include:

- The relevant concepts of the IESBA Code and the IESs as set forth in para. 23 of the ITC
- The incentives and disincentives within a firms system of quality control

Drivers and impediments that are largely beyond the control of standard setters include:

- The personal traits of individual auditors
- The culture in the jurisdiction.

One of the matters the IAASB could consider is whether it can reduce bias in its requirements, e.g. by not only requiring auditors to obtain evidence (merely) to confirm information. However, this issue would need to be addressed carefully so as not to change the audit model to one of seeking to disprove management assertions, which would involve an audit effort of more than an order of magnitude greater than is currently the case by changing the audit into a forensic-type audit.

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The most important issues identified in paragraph 37 from our viewpoint include:

- Clarifying what is meant by professional skepticism to ensure a consistent understanding across ISAs, IESs and the IESBA Code
- Exploring whether existing references to professional skepticism are clear as to expectations of auditors, including the need for evidence of the application of professional skepticism
- Exploring what actions by firms could enhance professional skepticism. For example, a QMA could be expected to include due consideration of firm-level risks to the appropriate exercise of professional skepticism and responses at a firm level. Firms could be proactive in supporting the exercise of professional skepticism by using training, incentives etc. In addition, in performing root cause analyses, firms could specifically consider whether inappropriate application of professional skepticism is an issue they need to address.

We do not believe that areas such as personal traits and how particular culture(s) impact the exercise of professional skepticism can realistically be addressed by the IAASB. However these are key impediments and may be more or less pronounced in individual jurisdictions around the world.

Rather than developing a framework for professional skepticism, which would involve a degree of understanding about the issue that is not available yet, we believe it would be helpful for the IAASB to develop principles for how professional skepticism is to be taken into account in its standard setting.

### **PS3.**

**Is the listing of areas being explored in paragraph 38–40 complete? If not, what other areas should we or the Joint Working Group consider and why? What do you think are the most important area to be considered?**

We have not identified any further areas beyond those noted in the ITC. In regard to the possible revision of ISA 540, we would encourage the IAASB to look at external inspection findings and related root cause analyses as discussed above, since accounting estimates are regularly recurring as focus issues for auditor oversight authorities.

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**PS4.**

**Do you believe the possible actions we might take in the context of our current projects relating to quality control and group audits will be effective in promoting improved application of professional skepticism? If not, why?**

We refer to our response to the questions in this section above. In particular, we believe it would be helpful for the IAASB to develop principles for how professional skepticism is to be taken into account in its standard setting.

**PS5.**

**What actions should others take to address the factors that inhibit the application of professional skepticism and the actions needed to mitigate them (e.g., the IAESB, the IESBA, other international standards setters or NSS, those charged with governance (including audit committee members), firms, or professional accountancy organizations)? Are there activities already completed or underway of which we and the Joint Working Group should be aware?**

As explained above, we believe that “fortitude” as explained in the ITC is an issue that the IESBA ought to address. This would require an exploration of the interaction, and separation from one another, of independence of mind, objectivity, integrity and due care, and professional skepticism. However, at this stage it is important that the IESBA not undertake projects that fundamentally change the concept of professional skepticism to applying beyond assurance engagements.

Furthermore, the impact that culture has on these factors ought to be explored (e.g., issues relating to social status).

We believe that the IAASB and the IESBA would be the most appropriate standard setters to act in this context. Any actions by the IAESB would need to be consistent with those of the IESBA and IAASB.

Member Institutes and firms need to deal with issues such as the recruitment of employees with appropriate personal traits and determining incentives and disincentives that foster professional skepticism. These issues could also be addressed in ISQC 1.

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**QUALITY CONTROL (INCLUDING QUESTIONS EXPLORING CROSSOVER ISSUES/ISSUES RELEVANT TO MORE THAN ONE PROJECT)**

***The following questions relate to quality control matters set out in paragraphs 45–190. If you believe actions relating to quality control beyond those discussed in these paragraphs should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.***

We refer to our responses to the general questions and our suggestions on the key issues for the IAASB within this project. In our view, the ITC is sufficiently comprehensive. We have not identified further matters.

**QC1.**

***We support a broader revision of ISQC 1 to include the use of a QMA as described in paragraphs 45–67.***

***a) Would use of a QMA help to improve audit quality? If not, why not? What challenges might there be in restructuring ISQC 1 to facilitate this approach?***

We strongly support the proposed new QMA, since it will improve the ability of firms to manage their firm quality risks and design appropriate responses thereto, which could be expected to lead to continual improvement of their systems. The risk-based approach also promotes a scalable approach to quality, which generally ought to be more appropriate for smaller firms. The IAASB should be sensitive to the environment in which smaller firms operate, and may need to provide specific guidance tailored to their needs, particularly where alignment to corporate governance principles (see para. 53) is concerned. The application of certain aspects of such principles may be overly complex for many SMPs as they were not primarily designed with small entities in mind.

However, where firms manage quality so as to address the specific risks (individual to the firms' circumstances and environment) that could impede the provision of services of high quality, both the firms and their stakeholders will benefit far more than from the more rigid current approach under ISQC 1.

We therefore believe that an effective QMA could help improve audit quality.

If the IAASB does decide to pursue the QMA considerable rewriting of much of ISQC 1 would likely be necessary.



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- b) *If ISQC 1 is restructured to require the firm's use of a QMA, in light of the objective of a QMA and the possible elements described in paragraphs 64 and Table 3, are there other elements that should be included? If so, what are they?***

However we do not believe that other elements need to be included, since the current proposal in Table 3 of the ITC is sufficiently comprehensive in that it includes the key elements.

- c) *In your view, how might a change to restructure ISQC 1 impact the ISAs, including those addressing quality control at the engagement level?***

QM at engagement level would be akin to project management, and would therefore focus on managing the detection risk element of audit risk for the individual engagement. As noted, the IAASB should consider whether certain aspects of firm policies and procedures in micro-firms (e.g., sole practitioners) can really be distinguished from quality control policies and procedures at engagement level.

- d) *If ISQC 1 is not restructured to require the firm's use of a QMA, do you believe that we should otherwise address the matters described in paragraph 59 and table 2, and if so, how?***

We believe that a QMA is essential if the IAASB is to do justice to the key areas explored in the ITC. This applies in particular to risks of not addressing quality objectives, scalability and QM in the non-audit context. In our view, some revisions as well as changes to the structure of ISQC 1 will be inevitable if the IAASB seeks to appropriately address the matters in the ITC.

## **QC2. Engagement Partner Roles and Responsibilities**

- a) *Paragraphs 69–86 set out matters relating to the roles and responsibilities of the engagement partner.***
- (i) *Which of the actions outlined in paragraphs 85–86 would be most meaningful to address issues related to engagement partner responsibilities?***
- (ii) *Why do you believe these actions are necessary?***

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***(iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***

***(iv) Describe any potential consequences of possible actions that you believe we need to consider further.***

An engagement partner needs to assume the leading role in relation to engagement quality. The stance this individual takes will have an important impact on the engagement team. We refer to the study: “The Association between Audit-Partner Quality and Engagement Quality: Evidence from Financial Report Misstatements”,<sup>1</sup> which emphasizes this. In our view, investment in engagement partner competencies etc. is potentially far more effective than detective and corrective controls – particularly those performed post-engagement.

The most important actions the IAASB could undertake include clarifying the engagement partner’s responsibilities throughout the audit in ISA 220 (and possibly other standards) to the extent not already sufficiently clear in the ISAs as a whole, and perhaps add an appendix summarizing requirements relating to the engagement partner. We note that other ISAs may implicitly require action on the part of the engagement partner already (e.g., ISA 315.10 implies the engagement partner’s involvement in a discussion of risk of material misstatement, but not necessarily in the risk assessment process).

When clarifying engagement partner responsibilities for engagement partners not located where the majority of the audit work is performed, the IAASB will need to be careful not to develop requirements that increase the engagement partner’s responsibilities beyond those applicable to engagement partners who are located where the majority of the audit work is performed. We suspect that this may prove challenging.

***b) Do you think it is necessary for the ISAs to include requirements or otherwise address the circumstances described in paragraph 79 in which an individual other than the engagement partner is required to or otherwise customarily sign(s) the auditor’s report or is named therein? If yes, please explain why, and provide your views about how this could be done (including describing the work effort you believe would be necessary for such an individual).***

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<sup>1</sup> Auditing: A Journal of Practice and Theory, Vol 34, No3 August 2015 (American Accounting Association)

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The signature of an auditor's report is foremost a legal matter in most jurisdictions, and therefore the ISAs cannot be too prescriptive in this regard, although the IAASB might usefully explore current practices. The fundamental ethical issue revolves around the need for those signing the auditor's report to have done enough work to satisfy themselves that affixing their signature is appropriate from an ethical point of view. They can of course draw upon work performed by others partners and members of staff. This in turn implies that the person signing does have, at a minimum, certain review responsibilities.

### **QC3. Others Involved in the Audit**

- a) **Paragraphs 87–104 set out matters relating to involvement of others in the audit:**
- (i) Which of the actions outlined in paragraphs 100–104 would be most meaningful to address issues related to others participating in the audit?**
  - (ii) Why do you believe these actions are necessary?**
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
  - (iv) Describe any potential consequences of possible actions that you believe we need to consider further.**

Many of the concerns detailed in paragraphs 94-95 seem to reflect mis- or non-application of the current standards, and thus point to the need for clarification or guidance rather than a revision of the relevant requirements.

In our view, the engagement partner needs to take overall responsibility for the audit, including for the involvement of component auditors, other auditors and auditor's experts. However, the engagement partner may delegate certain tasks in relation to the management of such involvement to the engagement team.

We agree that the IAASB should specifically clarify the role of the engagement partner in situations where other auditors (other than component auditors) are involved in the audit, as the application of ISA 600 in such situations has proven unclear in practice.

The mention of the possible application of ISA 600 currently in the introduction section of ISA 600.02 "an auditor may find this ISA... useful" is insufficient to ensure the engagement partner's involvement in work performed by other

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auditors in locations will be appropriate. The lack of clarity of what auditor responsibilities are in these cases was an issue identified by the firms and national standards setters in the IAASB ISA-Monitoring Project and has been a matter of some contention with some regulators. For this reason, some requirements are needed to govern such use, including a review process as part of a risk based approach.

We continue to believe that the inclusion in the auditor's report of a reference to the fact that other auditors performed certain work is inappropriate, as it detracts from the auditor's overall responsibility for the audit. In particular there are practical challenges where work is carried out by individuals in other locations or otherwise not directly within the environment of the engagement partner's firm, and so the ISAs need to recognize these challenges and address them in an appropriate manner. A lack of access to other auditors' working papers etc. represents a scope limitation that can be dealt with (and reported upon) in accordance with the extant ISAs.

Therefore, we do not agree with the suggestion in para. 101 that providing information on other auditors in the auditor's report would be worth exploring (again). We do not believe that such information is helpful, as what "another auditor" means may be unclear given the differences in networks. In addition, listing, for example, all auditors not from the same network may imply a different quality and this does not serve transparency in the spirit intended. We also believe that information on the use of an auditor's expert is inappropriate in the auditor's report, as it also detracts from the auditor having responsibility for the audit opinion. It would, however, be appropriate for such information to be made available to those charged with governance. The ISA implementation monitoring project should guide the need for any change in this area: otherwise the IAASB should not reopen this debate.

We support the IAASB considering on a case by case basis whether those responsibilities that are currently attributed to "the auditor" would be more appropriately assigned specifically to the engagement partner.

***b) Should we develop further requirements or application material for circumstances when other auditors are involved in an audit engagement (i.e., auditors that don't meet the definition of component auditors)?***

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As explained above, we agree that clarification would be useful, since the application of ISA 600 in situations where others (other than component auditors) are involved in the audit has proven unclear in practice.

**QC4. The Firms' Role in Supporting Quality**

- a) **Paragraphs 106–123 set out matters relating to networks of firms and use of ADMs.**
- (i) Which of the actions outlined in paragraphs 114–116 and 122–123 would be most meaningful to address issues related to firms operating as part of a network of firms and firms' changing business models and structures?**
  - (ii) Why do you believe these actions are necessary?**
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
  - (iv) Describe any potential consequences of possible actions that you believe we need to consider further.**
- b) **Specifically:**
- (i) What could we do to address the issues identified in the context of networks of firms? For example, should we develop more detailed requirements and application material to address reliance on network-level policies and procedures at a firm or engagement level?**
  - (ii) Do you think it would be feasible for us to develop requirements and guidance for networks? Please provide a basis for your views.**
  - (iii) Paragraphs 117–123 set out matters relating to the use of ADMs and related issues.**
    - a. How should our standards emphasize the importance of appropriate quality control processes in relation to use of ADMs?**
    - b. Are you aware of ADMs that raise issues not discussed in paragraphs? If so, please provide details.**

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We specifically welcome the IAASB's acknowledgement of the importance of maintaining principles-based standards (paragraph 114).

We agree that individual firms need to be able to justify any reliance on quality control measures at network level and that the IAASB should look specifically at this aspect. Given the different ways in which networks and their quality control arrangements may be organized, a flexible approach is needed. Following the principles of ISA 402 and ISAE 3402 may be appropriate in some cases, particularly for shared delivery centers. Where firms use shared delivery centers, such centers would need to be subject to the firm's QMAs; in some cases the "network" could monitor this proactively so as to address any issues as they arise and have some form of reporting in place to inform all "network firms" about their use of the shared delivery centers. We are aware that various different arrangements exist in practice, some networks have national initiatives, and others operate cross-border.

Paragraph 111 refers to concerns about the group engagement team relying on quality control policies and procedures at firm or network level without due consideration of a basis for doing so. Some additional clarification as to the interaction of requirements affecting the engagement partner in ISA 220 with those of the firm in ISQC 1 might be useful. For example, the reliance discussed in ISA 220.4 forms part of introductory material and is not explicitly reflected in the requirements.

We also agree that a firm's reactions to inspection findings should be explicitly addressed.

In regard to networks spanning jurisdictions, we believe that all factors listed in paragraph 242(c) need to be taken into account together, since these factors have a collective impact on the nature and extent to which the group auditor needs to be involved in the work of component auditors.

We do not believe it will be feasible for the IAASB to develop requirements specifically for networks given the differences in laws between jurisdictions and the very different nature of different networks. Indeed, since the term "network" is one that was created for independence purposes, the concept as defined in the IESBA Code may not be appropriate for addressing quality control issues. Consideration may need to be given to using a different term. Overall, a flexible, principles-based approach is needed. We have gained the impression that regulators may be calling for action by the IAASB where they themselves have been unable to act.

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Various ADMs are increasingly being used in practice – we agree that the clarifications listed in paragraph 122 (a)-(c) might be helpful, although they do not reflect a need to add to existing requirements. The IAASB could helpfully provide examples and guidance; however care needs to be taken to ensure that any new requirements are conditional in response to a firm's circumstances.

We note the concern raised in the 4<sup>th</sup> bullet point of paragraph 119 relating to the relative rigor of direction, supervision and review of different personnel at different locations. In our view, the location ought not to be the governing factor in this context given modern means of communication: rather the significance of work undertaken is a more important factor. For example, the direction, supervision and review of routine work (i.e., work of little complexity and requiring little use of professional judgement) with a low detection risk would be expected to differ from that governing work on complex, high risk areas requiring considerable professional judgment, irrespective of location. We suggest that clarification to this effect may be helpful.

#### **QC5–QC10 address the more significant issues relating to quality control specific matters**

##### ***QC5. Governance of the Firm, Including Leadership Responsibilities for Quality***

- a) ***Paragraphs 125–135 set out matters relating to governance of firms, including leadership responsibilities for quality.***
- (i) Which of the possible actions outlined in paragraphs 131–135 would be most meaningful in addressing issues related to firm governance and leadership responsibility for quality?***
  - (ii) Why do you believe these actions are necessary?***
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.***
- b) ***Specifically:***
- (i) Do you believe it is necessary for us to explore how the governance of a firm could be addressed in ISQC 1?***



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***(ii) Should ISQC 1 specifically address accountability of firm leadership, or appropriate personnel within firm leadership, for matters related to quality, including independence related matters? If so, how should this be done, and what direction should ISQC 1 provide to firms in appointing appropriate individuals to assume these responsibilities?***

***(iii) Would the use by firms of a QMA provide better support or context for the importance of quality-related responsibilities for firm leadership, and related accountability, and therefore better facilitate the ability of firms to address these matters?***

Much of the discussion about governance of audit firms centers on larger firms, and concerns expressed by oversight bodies responsible for their regulation. For smaller firms other considerations may apply, or there may be other ways in which objectives can be fulfilled. We urge the IAASB to remain sensitive to this in setting standards for international application by firms of varying size. In our view, the potential for firms to scale their QMA to their individual circumstances and environment is a key benefit compared to the current approach to quality control under ISQC 1.

Although we understand the concerns surrounding the lack of a requirement in ISQC 1 or ISA for assignment of formal responsibility for certain areas to a particular individual, we believe that this is an issue requires further clarification. Ultimately, the officers or managing partners of a firm are legally and administratively responsible for quality control systems within a firm: they can delegate functions and tasks in relation to these matters, but not their responsibility. In any case, officers and managing partners, or anyone to whom they have delegated specific functions or tasks, cannot be made strictly liable for breaches of firm policies and procedures, but only be made responsible for not having taken appropriate steps to develop and maintain an appropriate system. This is in line with the “business judgment rule” that applies to management of all organizations.

In this context, the idea put forward in paragraph 134 regarding a possible requirement for the identification of an individual responsible for independence is interesting, but may require more consideration of the practicalities involved. For example, the assignment of responsibility cannot mean that when another person violates the firm’s independence the assigned individual can be held responsible for that violation, unless systematic violations reveal that the system designed to ensure adherence to independence requirements had been inappropriately designed or is not operating effectively. In our view, it is more

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appropriate to require firms to have adequate systems in place, and for these to be operating effectively. Therefore, we believe that the IAASB should clarify to firms how governance is an important factor relating to quality rather than for the IAASB to require individuals be named on paper. ISQC 1 could, however, provide guidance on the sorts of responsibilities involved and their delineation as explained above.

We agree that reference to the importance of firms generally recognizing the need for the profession to act in the public interest could be included in a standard's introduction or application material. We do not, however, believe that it would be appropriate for standard setters, including the IESBA and the IAASB, to seek to formulate a requirement for auditors or firms to act in the public interest. Indeed, for the reasons discussed in the ITC, we agree that an objective or a requirement for individual professional accountants is neither desirable nor practicable. There is no commonly established definition of public interest, and it remains highly subjective. Neither firms nor individual auditors can determine what the public interest is in any given situation. It is the role of standards to provide requirements and guidance to assist the various members of the profession to meet their public interest mandates, and there ought to be no override (via an objective or a requirement) in either the IAASB's or IESBA's standards or code to the effect that firms or individuals shall act in the public interest.

We agree that the IAASB could explore how the governance of a firm could be addressed in ISQC 1. However, the IAASB will need to take into account the fact that different legal environments in different jurisdictions mean that governance structures may differ considerably. This means that the IAASB would only be able to develop any guidance in this area in very general terms.

As noted above, we support the IAASB introducing a QMA. Since this would largely be based on COSO ERM it would include issues such as objectives and determination of strategy to address identified risks to quality. Consequently, a QMA will integrate quality related responses into the firm's system of QM.

#### ***QC6. Engagement Quality Control Reviews and Engagement Quality Control Reviewers***

- a) ***Paragraphs 136–146 set out matters relating to engagement quality control reviews and engagement quality control reviewers.***

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- (i) Which of the possible actions outlined in paragraphs 143–146 would be most meaningful in addressing issues related to EQC reviews and EQC reviewers?*
  - (ii) Why do you believe these actions are necessary?*
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.*
- b) Specifically:**
- (i) Should ISQC 1 mandate the performance of EQC reviews beyond audits of listed entities? If yes, what other entities should be considered and how could we best define these entities? If no, please explain your reasoning.*
  - (ii) Do you believe it is necessary for ISQC 1 to require that firms define the minimum period of time between when an individual has been the engagement partner and when that individual would be eligible to serve as the EQC reviewer on the same engagement? If yes, how do you think this should be done and why? If no, please explain why.*
  - (iii) Would you support the development of a separate EQC review standard? Please explain the reasoning for your response.*

We appreciate the concerns relating to experiences with EQCR as discussed in the ITC and note the IAASB's acknowledgment of SMP perspectives and concerns.

We agree that a serious approach to QMA will involve firms implementing appropriate responses to quality risks they have identified, and that EQCR is an area the IAASB should now revisit in this context.

In this regard, we agree that proposals to revisit the selection criteria for audits requiring an EQCR identified in paragraph 143 are appropriate. We do not, however, agree that the IAASB should require an EQCR for all audits of public interest entities. We are aware that the IAASB discussed a similar proposal in determining the applicability of reporting on Key Audit Matters (KAM) within its recently completed auditor reporting project. The classification of which particular entities are of particular significance to the public interest is a matter for each jurisdiction, and cannot be satisfactorily resolved at an international

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level. Rather than formulating a blanket requirement to encompass all audits of PIEs, we suggest the IAASB develop application material to provide a clear path for determining the necessity for the EQCR based on the degree of public protection involved. For example, it could consider a presumption that financial institutions and insurers that accept deposits from the public or sell policies to the public, respectively, as requiring an EQCR. However, not all banks and insurance companies will necessarily fulfil such criteria – in these cases the presumption can be overcome. For example, investment banks or similar financial institutions that have few owners and creditors or depositors may not require an EQCR; similarly banks funded by other banks whose business is lending to companies may involve relatively low risk and thus a lower public interest. Equally insurance companies with limited insurance portfolios whose policy holders are sophisticated entities may not necessarily require an EQCR.

We agree that the IAASB should consider strengthening requirements and guidance as to the selection of an appropriate EQC-reviewer. Here the IAASB needs to be highly sensitive to the SMP concerns as regards the periods of time for any cooling off provisions. It might be detrimental to quality if smaller firms were driven to appoint a less suitable EQC reviewer by the need to comply with such requirements.

Documentation requirements could be strengthened where appropriate, but proportionate to the benefit of so doing.

It might be appropriate to expand application material to explain the terms and expectations of an EQCR and to also reflect the fact that other forms of review (internal and external) may contribute to audit quality. For example, having an IFRS expert review certain aspects of the audit may mean that the EQC-reviewer would not need to focus on this area even though the focus of the EQCR will be on risk areas. A blanket approach to EQCR (i.e., covering every aspect of the audit) would generally be inappropriate and excessive. In this context, the actions identified in the last bullet point of paragraph 143 appear to be appropriate for setting the minimum focus, as an EQCR should not be a re-performance exercise.

We do not support the proposal discussed in paragraph 144 for the IAASB to create a separate standard for EQCR. This could lead to calls for separate standards for others e.g., engagement partners, senior staff, junior staff etc. The EQCR is an integral part of quality control, not an exercise in its own right – hence a separate standard would provide too much prominence. Our concern would be that the relative role of the EQC-reviewer to that of the engagement

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partner might be lost if a separate standard were developed. In our view, scalability issues associated with the EQCR can be addressed by other means.

For similar reasons we do not believe that it would be appropriate to have an EQCR “announced” in the auditor’s report, which is also discussed in paragraph 144. Reporting publically about what is actually a firm-internal monitoring process could send the wrong signal about the audit, and whether users would actually benefit from such information remains unclear. Since, it is not necessarily true that a EQCR improves the actual quality of the audit, or that because an audit was subject to an EQCR it must have involved more risks than an audit without an EQCR, there is a danger that public reporting might infer either or both of these to be the case. Publically reporting EQCR could, in the longer term, lead to pressure for unnecessary performance of an EQCR. We do however believe that, as part of the firm’s quality monitoring, EQCR is an issue that ought to be of interest to those charged with governance, and its application should be reported to them.

We agree that clarification of the respective roles of the engagement partner and the EQC reviewer would be beneficial, since “muddying” their responsibilities could impact audit quality. In particular while the engagement partner has primary responsibility for the quality of the audit, the EQC-reviewer may contribute to quality, but does not necessarily do so. Clarification is required that the EQC reviewer’s responsibility is less than that of the engagement partner.

Since the EQCR is not a member of the engagement team, but part of the internal quality control process, it would not be appropriate to require the EQCR to communicate with those charged with governance, as discussed in paragraph 146. However, we believe that it may, in some circumstances, be appropriate for the engagement partner to inform those charged with governance of the fact that the firm will undertake an EQCR in respect of the engagement, as this is relevant to the latter’s responsibility for the quality of the audit. This may not be appropriate in all engagements, and the IAASB should be aware of the potential for unintended consequences in practice before considering a firm requirement in this area. Of course those charged with governance may seek communication with the EQC reviewer, should they deem it necessary.

#### ***QC7. Monitoring and Remediation***

- a) ***Paragraphs 147–159 set out matters relating to monitoring and remediation.***

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- (i) Which of the possible actions outlined in paragraphs 156–159 would be most meaningful in addressing issues related to monitoring and remediation?*
  - (ii) Why do you believe these actions are necessary?*
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.*
- b) Specifically:**
- (i) Do you support the incorporation of a new requirement(s) in ISQC 1 for firms to understand the causal factors of audit deficiencies relating to inspection findings and other reviews? If not, why? Are there any potential consequences or other challenges of taking this action that you believe we need to consider?*
  - (ii) Do you support the incorporation of a new requirement(s) in ISQC 1 for the results of the firm’s monitoring of the effectiveness and appropriateness of the remedial actions to be considered in the design and assessment of the effectiveness of the firm’s system of quality control? Please provide further detail to explain your response.*

We generally agree that a feedback mechanism dealing with remedial actions derived from inspections findings along the lines contemplated by COSO ERM will be needed as an integral part of a QMA.

We are also aware that various firms are using review mechanisms other than EQCR, and our members report that those mechanisms operating as the engagement progresses (e.g., “hot reviews”) are often more effective than so-called “cold reviews”. Indeed, introducing proactive mechanisms can potentially reduce the need for, or extent of, post-completion monitoring and review. Advances in technology are also driving progress in this area. These are factors we believe the IAASB should take into account.



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**QC8. Engagement Partner Performance and Rewards Systems**

**Paragraphs 160–170 set out matters relating to engagement partner performance and rewards systems.**

- a) Do you believe that establishing a link between compensation and quality in ISQC 1 would enhance audit quality? Why or why not?**
- b) What actions (if any) do you believe we should take in this regard? Are there potential consequences of possible actions that you believe we need to consider?**

We agree that some form of link between rewards and quality may potentially support quality. However disincentives and incentives can be just as powerful, and there may be a number of different ways in which firms could seek to employ these. Factors such as differing governance structures would also play a role in such determination. Firms will likely need to include various factors in their overall appraisal's structures as there may be multiple aspects of a partner's performance that will contribute to the overall figure of remuneration. In addition, whether a firm prefers to offer additional rewards for high quality or to impose disincentives for lower quality is not a matter that the IAASB can mandate. For these reasons, any requirements and guidance in this area would need to be principles-based.

Furthermore, as the ITC points out, linking performance and rewards may not be meaningful in the case of smaller SMPs, who due to reputational perceptions are already under market place pressure to maintain quality of service and where the partners performing the engagements are directly remunerated by fees earned. In our view, such policies would need to be left to individual firms to determine how best to deal with this aspect of quality management, and so any requirement in this area would have to be general rather than specific, and conditional in order to be practicable in the case of SMPs.

**QC9. Human Resources and Engagement Partner Competency**

- a) Paragraphs 171–187 set out matters relating to human resources and engagement partner competency.**
  - (i) Which of the possible actions outlined in paragraphs 176–178 and 187 would be most meaningful in addressing issues relating to human resources and engagement partner competency?**
  - (ii) Why do you believe these actions are necessary?**



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- (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.*
- (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.*
- b) Specifically, which of the possible actions outlined, or other actions not described, in paragraphs 176–178 and 187 would most positively impact audit quality:**
  - (i) Arising from issues related to knowledge, skills, competence and availability of a firm's partners and staff?*
  - (ii) Related to engagement partner competency?*
  - (iii) Why do you believe these actions are necessary? If you would not support a particular action, please explain why, including any potential consequences of those actions that you believe we need to consider.*

We believe that human resources management is key to a QMA.

We agree that clarification may be helpful in some areas. However, any requirement to align career development and promotion solely to quality management objectives will likely not be reasonable. We refer to our response regarding incentives and disincentives in response to QC8.

In regard to engagement partner competency we agree that a detailed review of the relationship between IES 8 and ISQC 1 / ISA 220 would be very helpful. We believe that integrating the notions of interpersonal and communication skills into ISQC 1 in any meaningful way would prove challenging.

#### **QC10. Transparency Reporting**

**Paragraphs 188–190 set out matters relating to transparency reporting.**

- a) Do you believe we are able to positively contribute to the evolving developments related to transparency reporting? If so, what, in your view, would be the most appropriate action we could take at this time?**
- b) If you would not support us taking actions as described in paragraph 190(b), please explain why, including any potential consequences of those actions that you believe we need to consider.**

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We refer to our response to G1.

We do not believe that international requirements for transparency reporting would be appropriate at the present time. There are currently very different objectives underlying the requirements in the few jurisdictions that already require transparency reporting.

We suggest that should the IAASB decide to look at this area, it continue the dialogue with interested parties, possibly developing a thought piece in due course as discussed in paragraph 190(b).

**The following questions are overall questions relating to quality control:**

**QC11.**

***Are there any other issues relating to quality control that we have not identified? If yes, please provide details. What actions should we take to address these issues?***

We refer to our general comments in our letter as to the need to focus more closely on key areas.

**QC12.**

***Are there any other specific actions that others could take in relation to quality control? If yes, please provide details.***

As noted in our response to GA2-GA9 below, we suggest that regulatory authorities pursue agreements to enable satisfactory access to component auditor documentation as a matter of some urgency.

We also urge the regulatory community to seek cooperation in determining how to best report findings in an appropriate manner. For example, when IFIAR representatives present an overview of combined findings of their members, it is unclear whether they have combined findings using different methodologies. However, the fact that figures for overall “audit deficiencies” are provided, has a detrimental impact on the trust the public places in the profession as a whole, which we do not believe to necessarily be justified by inappropriate accumulations of findings using different methodologies. In addition, we are aware that the methodologies change over time, which means that trend analyses would be inappropriate, even though they are published.

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Another factor that deserves further consideration is the need to instill better acceptance that a high quality audit should be acknowledged as a service of value and not as a mere commodity to be acquired as cheaply as possible. We would encourage the profession as well as regulators to promote this. In addition to its role in providing information to third parties, the audit provides valuable support to those charged with governance – in particular to audit committees in fulfilling their role in corporate governance.

**QC13.**

***Are there any specific considerations for SMPs related to the issues and potential actions described in this section? Are there any other considerations for SMPs of which we should be aware? If so, please provide details and views about these matters.***

Yes. In part we have commented on SMP issues in responding to many of the questions above. In general we believe that the adoption of a QMA in revising ISQC 1 would be beneficial as it would be more suitable for application by smaller firms because it is inherently scalable.

We are aware that many larger firms have already started to move towards a QMA, whereas we believe it is unlikely that SMPs will have consciously taken similar steps. However, we suspect that some aspects of QMA as discussed in the ITC may reflect general business practices already applied within many SMPs.

The challenge of coping with changes to standards is often disproportionate to SMPs, these do not have the same benefits of scale as may be the case in larger firms. However, a shift from a substantially rules-based ISQC 1 to a more flexible QMA ought to also provide an opportunity for SMPs to develop quality control measures better aligned to their individual circumstances.

In revising ISQC 1, the IAASB should ensure that conditional requirements and sliding scale requirements are responsive to the environment and situations of SMPs, so as to promote the scalable application of its quality control standards. This, together with a more risk-based approach under a QMA can mean that SMPs may face fewer difficulties than is currently the case under ISQC 1. Furthermore, we believe that the smallest SMPs (i.e., micro-firms) may find that quality control at firm level will overlap with quality control at engagement level.

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**QC14.**

***Are there any specific public sector considerations related to the issues and potential actions described in this section? Are there any other public sector considerations of which we should be aware? If so, please provide details and views about these matters.***

We have chosen not to comment on practicalities of auditing aspects in the public sector.

**GROUP AUDITS**

**The following questions relate to group audit matters set out in paragraphs 191–305. If you believe actions relating to group audits beyond those discussed in these paragraphs should be prioritized, please describe such actions and your supporting rationale as to why they require priority attention.**

We are concerned that many of the actions considered in relation to group audits would result in extension of requirements or a considerable amount of additional application material being added to ISA 600. When considered in isolation many of these actions appear to make sense, as they could clarify matters reportedly having caused concern in practice. However, when specific oversight findings indicate that a particular action has not been performed (or assumed not to have been performed due to a lack of appropriate documentation) changes in ISA 600 will only be helpful when they rectify misunderstandings. If, on the other hand, such findings result from failure to read and understand the ISAs sufficiently, the addition of material will possibly not have the desired impact. Indeed, increasing the length and complexity of standards may even inhibit their correct application for a variety of reasons (e.g., educational initiatives or changes to auditor methodology may be slow to catch up etc.). We urge the IAASB to bear this in mind in seeking to revise ISA 600.

Although all firms are affected by changes in standards, possibly it is the smaller firms worldwide that face the highest challenge in keeping up to date with change, especially when standards become increasingly prescriptive.

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**GA1.**

***We plan to revise ISA 600 (and other standards as appropriate) to respond to issues with group audits.***

- a) Should we increase the emphasis in ISA 600 on the need to apply all relevant ISAs in an audit of group financial statements? Will doing so help to achieve the flexibility that is needed to allow for ISA 600 to be more broadly applied and in a wide range of circumstances (see paragraphs 194–198)? If not, please explain why. What else could we do to address the issues set out in this consultation?***
- b) Would the actions we are exploring in relation to ISA 600 improve the quality of group audits? If not, why?***
- c) Should we further explore making reference to another auditor in an auditor's report? If yes, how does this impact the auditor's work effort?***
- d) What else could the IAASB do to address the issues highlighted or other issues of which you are aware? Why do these actions need priority attention?***

In view of the fact that ISA 600 is not intended to be a stand-alone standard as well as the feedback the IAASB has received, we agree that it may be helpful to refer to ISA 200.18 within ISA 600 so as to emphasize the need for auditors to apply all relevant ISAs in an audit of group financial statements. In particular, we agree that determination of the risk of material misstatement at group level demands involvement on the part of the group auditor. To the extent that this is considered to be unclear, we agree that it would be helpful for ISA 600 to clarify the group auditor's responsibilities.

In regard to the field of application of ISA 600 beyond a group audit, we refer to our response to QC 3, where we discuss the need for additional clarification. We agree that additional clarification as proposed in the ITC ought to be helpful in addressing the issues raised relating to misunderstandings concerning application.

We do not support the IAASB re exploring the question of whether an auditor should refer to other auditors in the auditor's report, as explained in our response to QC 3 above. In the EU, a group auditor is required to bear sole responsibility for the audit opinion, and we believe that the inclusion of a reference to other auditors would ultimately imply that the group auditor no longer bears sole responsibility.

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**GA2–GA9 address the more significant issues relating to group audits in greater detail.**

Access to the work of component auditors as well as to their documentation continues to be an issue in many group audits. We would encourage regulatory authorities to work towards finding satisfactory solutions.

Auditor oversight authorities need to be able to satisfy themselves that the group auditor has performed his or her role satisfactorily. However, they generally would not need access to component auditors' working papers. This does not imply that group auditors do not document the work they have performed on the work undertaken by component auditors.

**GA2. Acceptance and Continuance of the Group Audit Engagement**

- a) **Paragraphs 204–217 set out matters relating to acceptance and continuance of the group audit engagement.**
- (i) Which of the possible actions outlined in paragraphs 215–217 would be most meaningful in addressing issues related to acceptance and continuance procedures?**
  - (ii) Why do you believe these actions are necessary?**
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.**
- b) **Specifically:**
- (i) Are access issues as described in paragraph 207(a) still frequently being experienced in practice? If yes, please provide details and, where possible, explain how these are being addressed today.**
  - (ii) Do you agree that ISA 600 can or should be strengthened in relation to addressing access issues as part of acceptance and continuance?**
  - (iii) Would expanding the understanding required for acceptance and continuance, as described in paragraph 215 (b), be achievable in the case of a new audit engagement?**

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We comment on the possible actions identified in paragraph 215 as follows:

- a) We agree that it would be helpful to provide guidance to support the current requirements surrounding the timely identification of situations that indicate that obtaining sufficient audit evidence could be expected to be difficult or subject to significant complexities.
- b) We agree that additional clarification of application material might be helpful, provided the IAASB recognizes that there is a considerable difference between the information that could be expected to be obtained prior to any engagement acceptance decision and that is required to be obtained as part of risk assessment procedures.
- c) ISA 600.12 already contains a reference to the requirements in ISA 220 in explaining the group engagement partner's additional responsibilities for acceptance and continuance in response to situations generally encountered in group audits. Guidance explaining how the two ISAs are intended to interact with one another in a group situation would be more appropriate than duplication of requirements.
- d) To the extent that lack of understanding has driven the problems explained in the ITC, we agree that emphasizing what the preconditions for an audit mean in a group situation in practical terms may be useful. However, no changes to ISA 600 will be able to rectify a group auditor's inability to obtain appropriate access, where legal provisions preclude such access. The IAASB needs to be sensitive to the fact that even when local law pertaining to a particular component may preclude an engagement team obtaining appropriate access, there may be a legal requirement in the parent company's jurisdiction for group financial statements to be audited; although not necessarily using the auditor in question. However, when appropriate access cannot be obtained, a disclaimer of opinion may be inevitable.
- e) We are not convinced that including examples denoting possible problematical scenarios within standards will prove particularly helpful. As noted in d) above, there may be situations where appropriate access cannot be obtained.
- f) Should the IAASB decide to enhance the requirements relating to suitability of component auditors, we believe that it needs to be clear that consideration of all factors in ISA 600.A33 collectively and not in isolation is needed.



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We comment on the possible actions identified in paragraph 216 as follows:

- a) Requiring a specific conclusion could be difficult, especially in regard to acceptance of new clients. ISA 600 needs to recognize that there is a considerable difference between the quality of information that could be expected to be obtained prior to any engagement acceptance decision and that required to be obtained as part of risk assessment procedures. Any required conclusion could therefore not be based on audit evidence, but on expectations.
- b) Although we believe that a requirement for a conclusion may not be appropriate, we agree that clarification in application material may be helpful in this context, particularly as regards expectations of documentation at the time the engagement partner makes his or her decision as to acceptance or continuance.

We agree that the possible actions in paragraph 217 may be helpful in some cases, but we believe it is important for the IAASB to acknowledge that the auditor's degree of understanding will be limited prior to acceptance of an engagement, as we have pointed out above.

We are informed that situations are still encountered in practice that may preclude an auditor from obtaining appropriate access to necessary information. Where such situations are encountered, it may be impossible for the auditor to obtain sufficient appropriate audit evidence and thus a limitation of scope exists, such that a disclaimer of opinion will be inevitable.

### **GA3. Communications between the Group Engagement Team and Component Auditors**

- a) **Paragraphs 218–225 set out matters relating to communications between the group engagement team and component auditors.**
  - (i) **Which of the possible actions outlined in paragraph 224 would be most meaningful in addressing issues relating to communication between the group engagement team and the component auditor?**
  - (ii) **Why do you believe these actions are necessary?**
  - (iii) **Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why?**

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***(iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.***

We comment on the possible actions identified in paragraph 224 as follows:

- a) We believe that additional application material in ISA 600 could emphasize more the need for sufficient and timely two way communication between a group and component auditor. We do not see a need to extend existing requirements.
- b) If the IAASB decides to develop a standard for component auditors specific reference to communication would be appropriate.
- c) An explanation, in application material, of the term “timely” in the context of communication between a group and component auditor might be helpful.
- d) It might make sense to explain in the application material to ISA 600 the need for documentation in the context of communication between a group and component auditor and how compliance with ISA 230 is achieved in a group audit.
- e) The action needed will have to take due regard to legal requirements for client confidentiality in some jurisdictions that may preclude disclosure of NOCLAR.

We refer to our comments at the start of the section on group audits in relation to potential consequences of possible actions – viewed as a whole – that we believe the IAASB needs to consider further.

***GA4. Using the Work of the Component Auditors***

- a) ***Paragraphs 226–242 set out matters relating to using the work of the component auditors.***
  - (i) Which of the possible actions outlined in paragraph 234 and 242 would be most meaningful in addressing issues related to using the work of the component auditor?***
  - (ii) Why do you believe these actions are necessary?***
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.***

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**b) Specifically:**

- (i) Should the nature, timing and extent of involvement of the group engagement team in the work of the component auditor vary depending on the circumstances? If yes, how could changes to the standard best achieve this objective?**
- (ii) Should ISA 600 be strengthened to require the group engagement partner to make an explicit determination about whether the group engagement team can use the work of a potential component auditor?**

We comment on the possible actions identified in paragraph 234 as follows:

- a) We believe that additional guidance might make sense at the planning stage when the group auditor makes a final determination as to whether or not to request a particular component auditor to perform work. Pursuant to ISA 600.19 and 20 the group engagement team is already required to obtain an understanding of specific matters relevant to the component auditor. Application material in paragraph A33 explains how a sliding scale approach may be applied. We believe this approach remains fit for purpose when applied properly, and thus further clarification may be needed rather than additional objectives and requirements in this area.
- b) We agree that application material might be useful. We do not believe the word “challenge” is appropriate in this context. The group auditor does not need to “challenge” the competency of a potential component auditor – rather it is a question of being satisfied that the component auditor has the necessary independence and competence etc.
- c) We are not convinced that the addition of specific examples within the standards would prove helpful. Often examples are deemed as best practice to be followed in all cases, detracting from a principles-based approach and potentially being applied to inappropriate circumstances. However, examples or case studies may be useful beyond the standards as reference material or to assist e.g., in training.
- d) Guidance concerning licensing requirements would need to emphasize the need for the group auditor to take account of the collective consideration of all relevant factors in paragraph A33. Looking at licensing requirements in isolation would be unhelpful.
- e) We agree that the issue of determining reliance on common policies and procedures needs careful consideration, although not in isolation. The second sentence refers to the need to take account of other relevant

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factors (in paragraph A33 of ISA 600). In our view this is of particular importance in this context.

- f) Whilst we agree in theory that issues such as oversight findings could be relevant, we would like to point out that the issue of access is likely to be of practical relevance in many jurisdictions. This issue cannot be solved by introducing requirements into standards.

We comment on the possible actions identified in paragraph 242 as follows:

- a) We do not believe that it is necessary to strengthen ISA 600 in regard to the group auditor's involvement in work of component auditors. There are sufficient requirements in this area. However, their application in practice seems to be the issue, and so would best be dealt with by providing clarification. In this context, we do, however, agree that ISA 600 cannot be overly prescriptive as to how this involvement may be achieved in practice.
- b) We are not convinced that the need for professional skepticism should be emphasized in the context of interactions between group and component auditors, since this is not an area demanding skepticism; rather professional judgment and application of the risk based audit is called for. We support clarification of interrelationships between specified existing paragraphs in ISA 600 would be helpful.
- c) As noted elsewhere we do not believe that extensive use of illustrative examples in ISA 600 would necessarily be helpful. We believe it is important to emphasize the need to take all factors collectively (i.e., ISA 600.A33) into account in the context of the group auditor's consideration of a particular component auditor, as there can be trade-offs between individual factors.

The nature, timing and extent of involvement of the group engagement team in the work of the component auditor definitely need to vary depending on the circumstances. ISA 600 uses a sliding scale approach in A33 whereby all of the factors need to be viewed collectively, not in isolation.

It is not appropriate for the group auditor to (blindly) rely on common policies and procedures without further consideration. Group auditors would need to satisfy themselves that monitoring of common policies and procedures was applied satisfactorily. We agree that ISA 600 should be strengthened to require an explicit determination about whether the group engagement team can use the work of a potential component auditor. In our opinion this determination need not necessarily be made by the group engagement partner, but – in most

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cases – could be performed as part of planning work by the engagement team that is reviewed by the engagement partner.

**GA5. Identifying and Assessing the Risks of Material Misstatement in a Group Audit**

- a) **Paragraphs 243–253 set out matters relating to identifying and assessing significant risks in a group audit:**
- (i) Which of the possible actions outlined in paragraphs 251–253 would be most meaningful to address issues relating to identifying significant risks for the group audit?**
  - (ii) Why do you believe these actions are necessary?**
  - (iii) Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
  - (iv) Please also describe any potential consequences of possible actions that you believe we need to consider further.**

We agree with the contention in paragraph 251 that taken together ISAs 315, 330 and 600 already include adequate requirements whereby a group auditor shall obtain the necessary understanding of the group and its environment. It therefore appears that it is the issues noted in paragraph 244 of the ITC that appear to need IAASB action.

To the extent that group auditors are not becoming sufficiently involved in risk assessment and risk response for group audits, we appreciate that ISA 600 might usefully be more explicit as to how the requirements of ISAs 315 and 330 would be applied in group audits. In particular, adding application material to make the links between these standards more prominent as proposed in paragraph 252 may be helpful. In addition, we believe the IAASB should develop application material dealing explicitly with relatively new situations that are increasingly encountered in practice, e.g., shared services, outsourcing etc. Factors such as shared service centers are increasingly becoming an issue in practice.

We comment on the possible actions identified in paragraph 253 as follows:

- a) We would discourage the IAASB from including too many examples within its standards. In this specific instance, we do not believe that examples would be particularly helpful. We suggest the links between

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ISA 600 and 315 and 330 be improved, as then additional examples would not be necessary.

- b) We agree that application material may be helpful in clarifying the requirements of ISA 315 27-29 concerning identification of significant risk in a group situation.
- c) It is already implicit in ISA 600.09(m)(ii) that a component is a significant component when it is likely to include significant risks of material misstatement of the group financial statements. We have difficulty in understanding the interrelationship between the identification of significant risks on the one hand and classification of components as significant and non-significant on the other, should circumstances arise whereby a significant risk that is pervasive to the group is not necessarily identified as a significant risk for an individual component viewed in isolation. We agree that clarification of such a circumstance would be helpful.
- d) We agree that clarification of how the phrase “of financial significance to the group” is intended to be interpreted in the context of the group auditor’s materiality considerations would be helpful.

**GA6. Issues Relating to Component Materiality and Other Aspects of Materiality Relevant to Group Audits**

- a) ***Paragraphs 254–261 set out issues relating to applying the concept of materiality in a group audit. Do you agree with the possible actions recommended in paragraph 261 to clarify the different aspects of materiality in a group audit? If not, please indicate which actions are not appropriate and describe why.***
- b) ***Recognizing that significant changes to ISA 320 will not be contemplated until a review of ISA 320 has been performed in its entirety (potentially as part of a future project to address materiality more broadly), please describe any other relevant issues or additional actions that you think may be appropriate relating to component materiality, component performance materiality or the clearly trivial threshold at the component level.***

We fully agree with the statement in paragraph 261 that any of the actions the IAASB may take in regard to the application of ISA 320 in a group audit should not infringe on the basic principles of ISA 320.

We comment on the possible actions identified in paragraph 261 as follows:



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- a) We accept that improved guidance, provided it retains the principles-based approach of the ISAs, may be helpful.
- b) We agree that the IAASB might explore the application of materiality where work on the financial information of a component is other than an audit of the financial information.

**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)**

- a) **Paragraphs 262–292 set out matters relating to responding to identified risk of material misstatement in a group audit (including the group engagement team's involvement in the consolidation process).**
  - (i) **Which of the actions outlined in paragraphs 272–273, 279, 288 and 292 would be most meaningful to address issues relating to responding to identified risks of material misstatement in a group audit?**
  - (ii) **Why do you believe these actions are necessary?**
  - (iii) **Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.**
  - (iv) **Please also describe any potential consequences of possible actions that you believe we need to consider further.**

We comment on the possible actions identified in paragraph 272 as follows:

- a) We support enhancements that could improve the effectiveness of group audits, and agree that greater flexibility in terms of the types of work required for significant and non-significant components is appropriate. Certainly, a “full audit” of the financial statements of a component may not always be necessary in addressing identified risks at group level. For example, where a significant component is denoted as such because of a particular significant risk, it may be more appropriate for the work effort to be tailored to addressing that one risk. The extant requirements of ISA 600.27 already allow flexibility in such situations.
- b) We agree that further clarification of the work effort regarding both significant and non-significant components may be helpful.



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- i. Although we agree that further clarification of the extent of work effort for a significant component may be helpful, we strongly disagree with the proposal to use the term “audit of financial information” together with the explanation that not all requirements of all relevant ISAs would necessarily be followed. If a component auditor is required to express an opinion, then all relevant requirements of all relevant ISAs would apply. If the IAASB decides to provide guidance on a more flexible approach, it should instead refer to the component auditor “performing audit work” on behalf of the group auditor when performing work of an audit nature to satisfy the instructions or the objective set by the group auditor. This should be distinguished from “performing audit procedures” on behalf of the group auditor, in which the group auditor specifies at least the nature and timing (and perhaps the extent) of audit procedures, but requires the component auditor to exercise judgment in their planning, performance and in reaching conclusions. In contrast, “performing specified procedures” should be limited to those cases in which the group auditor specifies the procedures such that the component auditor does not need to apply judgment in their application or in reaching factual findings (like in an agreed-upon-procedures engagement).
- ii. We agree that clarifying terminology where not clear in a group situation and emphasizing the need for clear instructions from the group auditor to the component auditor i.e., to achieve a mutual understanding of work to be performed may be helpful.
- iii. The IAASB needs to be clear in using different terminology. As noted above, care needs to be taken to distinguish between “specified procedures/ agreed upon procedures” and “agreed upon audit procedures/ specified audit procedures”. The former are dealt with in ISRS 4400 whereby the component auditor does not exercise professional judgement, but reports only factual findings. In contrast, for agreed upon/ specified audit procedures, although the nature of the procedure would be pre-determined, the component auditor exercises judgment in how the procedure is performed (i.e., sample size, timing etc.) and uses professional judgment to draw a conclusion on the audit procedures performed (not an audit opinion).
- iv. We refer to our response in iii above.

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- v. We agree that additional application material to provide clarification of the work effort for analytical procedures at group level in relation to non-significant components may be helpful.
- vi. We agree that clarification may be helpful as to the component auditor's work when, for example, a stand-alone audit of component financial statements has been performed.

We comment on the possible actions identified in paragraph 279 as follows:

- We agree that it makes sense for the IAASB to address the need for and amount of work required in relation to non-significant components. We also agree that reviews of financial statements may not always be appropriate course of action, and that this be explored further.
- We refer to our comments above in relation to the terms "specified procedures" and "specified audit procedures".

We comment on the possible actions identified in paragraph 288 as follows:

- We agree with the proposals, with the exception of proposed elevation of text from appendix 2 in ISA 600.

We comment on the possible actions identified in paragraph 292 as follows:

- The proposed clarifications make sense.

**b) Specifically:**

- (i) What are your views on scoping the audit based on identifying and assessing the risks of material misstatement for the group as a whole, rather than focusing the determination of the necessary work effort on the determination of whether components are considered significant or non-significant? Are there any practical challenges that we need to consider further?**
- (ii) Are there other possible actions related to auditing groups where there are a large number of non-significant components that we should explore? Are there other approaches to auditing such groups that need to be considered? Do the possible actions presented lead to any additional practical challenges?**
- (iii) Should the standard be strengthened for the group engagement team to be more involved at the sub-consolidation level in the**

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***appropriate circumstances? Are there further issues or practical challenges that have not been considered?***

***(iv) Should the requirements or application material relating to subsequent event procedures be strengthened or clarified? Are there further issues or practical challenges that have not been considered?***

- (i) In our view, both risk assessment and component significance need to be retained. The risk assessment at group level is a key aspect in determining whether a particular component is significant.
- (ii) We are not aware of appropriate alternatives to that already required for dealing with groups where there are a large number of non-significant components.
- (iii) We agree that the standard should be strengthened in regard to group engagement team to involvement at the sub-consolidation level. However there may be practical challenges, e.g., access considerations etc. which the IAASB will need to recognize, since ISA 600 should not require what may not be possible in practice.
- (iv) We agree that it would be appropriate for the requirements or application material relating to subsequent event procedures to be strengthened or clarified.

***GA8. Review and Evaluation of the Work of Component Auditors by the Group Engagement Team***

- a) ***Paragraphs 293–303 set out matters relating to the review and evaluation of the work of component auditors by the group engagement team.***
  - (i) ***Which of the actions outlined in paragraphs 299 and 303 would be most meaningful in addressing issues relating to the review and evaluation of the work of component auditors by the group engagement team?***
  - (ii) ***Why do you believe these actions are necessary?***
  - (iii) ***Are there other relevant issues that we should consider, or actions that would be more effective than those described? If you would not support a particular action, please explain why.***
  - (iv) ***Please also describe any potential consequences of those actions that you believe we need to consider further.***

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We comment on the possible actions identified in paragraph 299 as follows:

- We agree that it would be helpful to clarify the extent of the group engagement team's review of component auditors' work. We believe that it is essential for the IAASB to ensure that the extent of such review does not exceed that undertaken in a non-group audit engagement.
- We agree that clarification of documentation pertaining to communication between the group auditor and the component auditor, including review of the latter's work would be helpful.

We comment on the possible actions identified in paragraph 303 as follows:

- We agree that it would be helpful to strengthen the required communication between the group engagement team and component auditor.
- We agree that clarification of the group auditor's documentation pertaining to findings from the component auditor's work would be helpful.

#### **GA9. *The Impact of New and Revised Auditing Standards***

***How should the matters set out in paragraphs 304–305 be addressed in our plans to revise ISA 600? Are there any other implications from our new or revised standards that should be considered? The following questions are overall questions relating to group audits:***

In regard to disclosures, we do not see a need for further new action by the IAASB. It may be helpful to include a reference to ISA 701, to highlight the necessity to consider matters relevant to auditor reporting of KAM.

#### **GA10.**

***Are there any other issues relating to group audits that we have not identified? If yes, please provide details. What actions should we take to address these issues?***

We are not aware of any such issues.

#### **GA11.**

***Are there any other specific actions that others could take in relation to group audits? If yes, please provide details.***

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We are not aware of any such actions that could be taken by others other than, as we noted above, regulators in different jurisdictions reaching agreement on access to component auditor documentation.

**GA12.**

***Are there any specific considerations for SMPs related to the issues and potential actions described in this section? Are there any other considerations for SMPs of which we should be aware? If so, please provide details and views about these matters.***

Yes. The IAASB will need to be careful to be sure that those changes it makes to ISA 600 and other standards can be applied in the audit of smaller groups. There are very many such audits performed on a world-wide basis.

In addition, SMPs are often involved in group audits in the capacity of component auditor. We have commented above as to the need for the IAASB to bear in mind that, under its standards, audit firms that are not part of a network are not treated differently from auditors that are. It is therefore important for the IAASB to stress that the criteria it establishes for evaluating the suitability of component auditors are assessed on the basis of “taken as a whole” using the factors in ISA 600.A33 rather than viewed in isolation.

**GA13.**

***Are there any specific public sector considerations related to the issues and potential actions described in this section? Are there any other public sector considerations of which we should be aware? If so, please provide details and views about these matters.***

We have chosen not to comment as to specific public sector considerations.