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Dear Tom,

**Response to the IAASB’s Exposure Draft (ED), Proposed International Standard on Auditing 600 (Revised) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)***

EFAA appreciates the opportunity to provide our comments on the ED, [Proposed International Standard on Auditing 600 \(Revised\) \*Special Considerations – Audits of Group Financial Statements \(Including the Work of Component Auditors\)\*](#) (ED-600). Our response has been prepared with input from our Assurance Expert Group.

The European Federation of Accountants and Auditors for SMEs (“EFAA”) represents accountants and auditors providing professional services primarily to SMEs both within the European Union and Europe as a whole. Constituents are mainly small practitioners (“SMPs”), including a significant number of sole practitioners. EFAA’s members, therefore, are SMEs themselves, and provide a range of professional services (e.g. audit, accounting, bookkeeping, tax and business advice) to SMEs. EFAA represents 13 national accounting, auditing and tax advisor organisations with more than 350,000 individual members.

**GENERAL COMMENTS**

We support the IAASB’s initiative to strengthen ISA 600 (Revised) as it promises to enhance the audit quality of the world’s largest and most complex companies. The project is also highly relevant to SMPs as oftentimes they are component auditors.

We generally support a risk-based approach to the audit of the group financial statement. However, we are concerned that ED-600 may prove prejudicial to component auditors, by promoting a migration of audit work from SMPs to larger firms or networks. This may reduce choice and competition, while increasing concentration, in the market for audit services thereby increasing cost and reducing quality for the client and their stakeholders. We believe this is detrimental to the public interest. Therefore, we strongly urge the Board, while examining responses and other feedback to the ED-600, to conduct a rigorous impact analysis of the likely effect of ED-600, and the related changes to ISA 220, on the audit market - auditor selection, choice, competition, and concentration as well as the cost and quality of audit

Specifically, the removal of the requirement for an audit of significant components and allowing the group engagement team (GET) to elect to perform all the risk identification, assessment and response procedures without recourse to component auditors – a top down approach - may impair the quality of the audit of the group financial statements.

The GET's election may arise from its over optimism in its ability to perform the risk assessments on its own. In the absence of component auditors of significant components performing an audit, we fear that the risk identification and assessment procedures for certain classes of transactions, account balances and disclosures may be less effective and adversely impact the design and performance of risk response procedures. Therefore, we believe appropriate safeguards, perhaps in the form of additional requirements, may be necessary so as to ensure that the GET is motivated to obtain sufficient knowledge of significant components, typically via the component auditor's involvement.

We also suspect that the proposed top-down approach may lead to group auditors *either* reducing their reliance on the work of component auditors *or* selecting different component auditors for the group audit than at present. Group auditors may prefer to have their own firm or network be the component auditor not least because of familiarity and practical simplicity. This may result in fewer SMPs being engaged as component auditors.

Finally, we also fear that removal of the requirement for the audit of significant components will diminish the perception of the value of the statutory audit. This may ultimately result in national regulators raising audit thresholds to exempt more entities from the audit requirement. As [our research](#) has shown SMEs yield significant benefit from an audit.

## QUESTIONS IN THE ED

### Overall Questions

#### 1. *With respect to the linkages to other standards:*

##### **(a) Does ED-600 have appropriate linkages to other ISAs and with the proposed ISQMs?**

ED-600 has appropriate linkages to other ISAs and with the proposed ISQMs.

However, as explained below, the inclusion of component auditors in the engagement team per ISA 220 poses practical difficulties in group audits especially when component auditors are from outside the GET's firm or network and the GET decides to proceed with the group audit engagement without the involvement of a component auditor.

##### **(b) Does ED-600 sufficiently address the special considerations in a group audit with respect to applying the requirements and application material in other relevant ISAs, including proposed ISA 220 (Revised)? Are there other special considerations for a group audit that you believe have not been addressed in ED-600?**

We have some serious concerns.

We fear that the inclusion of component auditors within the engagement team will tend to discourage the use of component auditors, especially SMPs. There are various reasons why the GET might not choose to use component auditors. First, using component auditors, especially those from a different network using different audit methodologies and quality management systems, will likely result in more work and practical issues for the GET. Hence, the GET will be motivated to find ways of performing work centrally or dealing with

members of the same office, firm, or network. Second, the GET and the client may wish to avoid any complexities arising from a variation in audit firm rotation requirements across different jurisdictions that make auditor selection across the group difficult to manage. It will be easier to involve only the firm of the GET across the group. Third, component audits may be subject to different audit completion deadlines. Where the group audit deadlines are before those of components' audits, say to mitigate the risk of delays, meeting more stringent group reporting deadlines could be more easily achieved if the GET opts not to rely on work performed as part of a statutory audit at the component level. Rather than requesting the audit work to be accelerated to meet group reporting deadlines the GET may elect to perform the work itself or request another team from its firm or network to do it. The statutory audit for the component would then be completed subsequently with no impact on the group audit. The client might then be tempted to question the need for the audit at the component level and elect not to if such an option is available.

**2. *With respect to the structure of the standard, do you support the placement of sub-sections throughout ED-600 that highlight the requirements when component auditors are involved?***

We support the placement of sub-sections.

We suspect SMPs engaged as component auditors will welcome how the standard distinguishes between the GET and the component auditors' responsibilities. If component auditors are not involved these sub-sections are not applicable making it easier to navigate through the ISA.

As explained previously if component auditors are not used audit quality may be impaired. Hence, we urge the Board to consider how it can most effectively drive the group engagement partner's decision as to the optimal engagement team composition and to articulate this throughout the standard.

**3. *Do the requirements and application material of ED-600 appropriately reinforce the exercise of professional skepticism in relation to an audit of group financial statements?***

We believe ED-600 appropriately reinforces the exercise of professional skepticism in relation to group financial statements. Nevertheless, we believe it will be difficult for the group engagement team to assess whether component auditors have exercised professional skepticism in practice so the Board might wish to consider providing some examples of the different kinds of biases.

***Specific Questions***

**4. *Is the scope and applicability of ED-600 clear? In that regard, do you support the definition of group financial statements, including the linkage to a consolidation process? If you do not support the proposed scope and applicability of ED-600, what alternative(s) would you suggest (please describe why you believe such alternative(s) would be more appropriate and practicable).***

We believe the scope and applicability is sufficiently clear and support the definition of group financial statements.

- 5. Do you believe the proposed standard is scalable to groups of different sizes and complexities, recognizing that group financial statements, as defined in ED-600, include the financial information of more than one entity or business unit? If not, what suggestions do you have for improving the scalability of the standard?**

We believe in general the proposed standard is scalable to groups of different sizes and complexities.

However, as previously explained, there is a risk that leaving the decision on the work to be performed and by whom solely to the GET's discretion will result in the group auditor electing to perform all risk identification, assessment and response procedures without recourse to component auditors. This may detract from audit quality. The component auditor may have specific in-depth knowledge and expertise, which the GET will not be able to benefit from without their involvement. This could result in some risks of material misstatement being missed as the GET may not be able to make fully informed judgments. The Board needs to determine how to ensure the GET appropriately exercises its discretion. Hence, there may be a need for tighter requirements for an audit approach relating to the involvement of component auditors.

In due course it will be interesting to see whether, and if so how, the Board plans to address audit of less complex groups in its proposed audit standard for less complex entities.

- 6. Do you support the revised definition of a component to focus on the 'auditor view' of the entities and business units comprising the group for purposes of planning and performing the group audit?**

We support in general the revised definition of a component.

There is a risk, however, that the group auditor's use of a different structure than the legal structure results in inefficiencies and practical difficulties, especially when component auditors are involved. For example, to whom are confirmation and representation letters addressed. Practical examples might clarify this.

- 7. With respect to the acceptance and continuance of group audit engagements, do you support the enhancements to the requirements and application material and, in particular, whether ED-600 appropriately addresses restrictions on access to information and people and ways in which the group engagement team can overcome such restrictions?**

We support the enhancements.

- 8. Will the risk-based approach result in an appropriate assessment of the risks of material misstatement of the group financial statements and the design and performance of appropriate responses to those assessed risks?**

On the one hand, adoption of the risk-based approach is intuitive and aligned with ISA 315 (Revised): risk assessment should be driving the work effort of the audit rather than whether the component is significant. On the other hand, removal of the requirement for an audit of significant components and allowing the GET to elect to perform all risk identification, assessment, and response procedures without recourse to component auditors could be detrimental to audit quality of the group audit statements. Moreover, in certain instances it may be more efficient for the component auditor to perform the risk assessment and design procedures to address the risks,

and then have those reviewed and approved by the GET. That is, it may be more efficient and effective to audit the financial information of the component in its entirety, rather than designing and performing further audit procedures, which may not cover all of the information of what used to be called a component and thus, potentially impacting the quality of the group audit engagement.

*In particular, the IAASB is interested in views about:*

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

We believe the respective responsibilities of the group engagement team and component auditors are clear. We are, however, concerned about the potential exclusion of component auditors and the adverse implications this might have for audit quality.

Specifically, we are concerned about the absence of guidance, in the shape of application material or requirements, to ensure component auditors are used in group audit circumstances in order to reinforce audit quality. While the application material in ED-600 concentrates on the difficulties for the group engagement partner and GET of using component auditors, the fact that component auditors from outside the firm or network cannot be subject to the same incentives as those within the firm of the group engagement partner is not addressed. We fear that component auditors may be prejudiced when engagement teams for group audits are being established.

While two-way communication is mentioned the descriptions focus on top-down communication. Since the component auditors have the best understanding of the components, we recommend stressing the need for bottom-up communication and involving the component auditors early in the process of the group audit.

We note that *Appendix 5 Required and additional matters included in the group engagement team's letter of instruction* in extant ISA 600 has been removed since, as the Explanatory Memorandum states, this is now incorporated into the standard itself. However, we consider this Appendix as useful, as it provides a summary and it is not stated in documentation requirements, and so recommend it be retained.

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

We believe the interactions are clear.

However, as previously explained, we are concerned at the risk of the GET inchoate not to involve component auditors, especially when their involvement would have been appropriate.

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

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

We foresee various practical challenges. First, if the risk assessment changes during the audit, as a result of the work of component auditors, will there be sufficient time and resource to adequately respond to these changes and make appropriate adjustments to the group audit plan and procedures to be performed. Second, will the required information be received in time from the component auditor. Third, will the work of the component auditor be of sufficient and appropriate quality: it might be better to elevate some of the application material related to ensuring sufficient and appropriate work by the component auditor to requirements. Fourth, it is not clear what the difference is between component auditors and statutory auditors and how the group audit is to be combined with a statutory audit. Fifth, it is not clear how reporting and clearance between component auditor and group audit team is arranged. And finally, how will the component auditor be able to sign off if important information is not shared by the group.

**9. Do you support the additional application material on the commonality of controls and centralized activities, and is this application material clear and appropriate?**

We support the additional application material which we believe is clear and appropriate.

**10. Do you support the focus in ED-600 on component performance materiality, including the additional application material that has been included on aggregation risk and factors to consider in determining component performance materiality?**

We have some concerns.

While we support the revised approach to determining component performance materiality and the corresponding application material, we believe more guidance, perhaps in the form of a staff publication might be useful. We also believe that performance materiality for transaction classes and so on is overly complicated.

**11. Do you support the enhanced requirements and application material on documentation, including the linkage to the requirements of ISA 230? In particular:**

**(a) Are there specific matters that you believe should be documented other than those described in paragraph 57 of ED-600?**

We believe the matters described are accurate and complete.

**(b) Do you agree with the application material in paragraphs A129 and A130 of ED-600 relating to the group engagement team's audit documentation when access to component auditor documentation is restricted?**

We agree in general with the application material.

However, the application material seems to suggest that the GET is required to include component auditor's documentation in the documentation of the GET when there are access difficulties across borders. This would

mean that members of the engagement team may need to visit the premises of the component auditor. We believe they should only be required to document the nature, timing, and extent of their review of the work of the component auditor and not the details of the procedures performed.

**12. Are there any other matters you would like to raise in relation to ED-600?**

We have no other matters to raise.

**Request for General Comments**

**13. The IAASB is also seeking comments on the matters set out below:**

**(a) Translations—Recognizing that many respondents may intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues respondents note in reviewing the ED-600.**

We have no comments. We trust the Board will ensure the final text can be unambiguously translated.

**(b) Effective Date—Recognizing that ED-600 is a substantive revision, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning approximately 18 months after approval of a final ISA. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA.**

We believe an appropriate effective date for the standard would be for financial reporting periods beginning approximately 24 months after approval of a final ISA.

**OTHER COMMENTS**

The Board should consider the merits of the ISA including a statement as to the importance, or necessity even, for component auditors to cooperate with the group auditors including facilitating the review of working papers of the component where applicable.

Finally, the Board needs to start thinking whether, and if so, how the proposed new standard for the audit of less complex entities (LCEs) deals with the audit of less complex groups.

**CONCLUDING COMMENTS**

We trust that the above is clear, but if you have any questions on our comments, please do not hesitate to contact us.

Yours faithfully,

Salvador Marin

President

Paul Thompson

Director