



THE IAASB'S INVITATION TO COMMENT

Agenda Item 8. AUASB Meeting 22 February 2016

Why is this consultation important to you?

Auditors play a key role in contributing to the credibility of the financial statements on which they are reporting. High-quality audits support financial stability. As the global auditing standard setter,¹ we have a public interest responsibility to develop standards and guidance for auditors to facilitate high-quality audits being achieved – which in turn builds public trust and confidence in financial statements and financial reporting more broadly.

Who should respond?

We want to hear from all of our stakeholders. In particular, this Invitation to Comment (ITC) is targeted at:

- Firms.
- Regulators and audit oversight bodies.
- National auditing standard setters (NSS).
- Public sector organizations.
- Professional accountancy organizations.
- Others with an interest in the technical aspects of our standards.

What does our consultation address?

Our auditing and quality control standards need to stay relevant in the face of continually changing circumstances in diverse jurisdictions. We are focused on three priority topics – professional skepticism, quality control, and group audits. In addition to outlining the public interest issues we believe should be addressed as a matter of priority, this ITC is intended to facilitate responses from those interested in the more detailed aspects of our consultation, including:

- How our standards currently address various matters.
- Concerns we have noted about these matters.
- Possible actions we may take in response, including highlighting specific areas in our standards that we might improve to enhance audit quality.
- More specific questions we would like to have answered.

How does this ITC relate to the Overview?

We have also published an *Overview of the IAASB's Invitation to Comment, Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits* (Overview). Readers of this ITC may find the Overview useful to facilitate outreach activities or summarize the key areas we are exploring and the direction we may take. The Overview includes 9 specific questions, which have also been repeated in this ITC. All responses to both documents will be considered.

What do we want to hear from you and why are we reaching out now?

Our work is at an early stage. We want to make sure we understand your needs and expectations about where enhancements to audit quality are needed and your views about what direction our work should take. We want to hear about matters we should address in the public interest. We want you to tell us whether we have identified the right issues, what you think causes these issues, and whether our possible actions to respond to these issues will be meaningful, or if other actions may be more effective. We have learned that asking questions at an early stage helps us more effectively develop and revise our standards.

¹ The IAASB develops auditing and assurance standards and guidance by use for all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board (PIOB), which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

The objective of the IAASB is to serve the public interest by setting high-quality quality auditing, assurance, and other related standards and by facilitating the convergence of international and national auditing and assurance standards, thereby enhancing the quality and consistency of practice throughout the world and strengthened public confidence in the global auditing and assurance profession.

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Questions on the specific sections are included on page 87. Links to these specific questions can be found in the individual sections.

We are not the only organization that can influence audit quality. As the global auditing standard setter, we encourage cooperation and debate among regulators, policymakers, NSS and other stakeholders. Therefore, we are also asking for your views about what others can do to improve audit quality.

What outputs might come about because of our work?

The possible actions set out in this ITC relate predominantly to standard-setting activities we could undertake, specifically developing or revising requirements, application material or both in our existing standards. To effectively address the issues that have been noted, it may be necessary for us and others to complement our standard-setting activities with activities such as:

- Development of non-authoritative guidance (such as an International Auditing Practice Note (IAPN) or Staff publications.
- Development of relevant guidance on particular topics by NSS and professional accountancy organizations.
- Development of information papers on particular topics by the Forum of Firms.
- Development of training or educational materials for auditors (for example, by the IFAC Small and Medium Practices (SMP) Committee or others).

How will your feedback be considered and how can you send it to us?

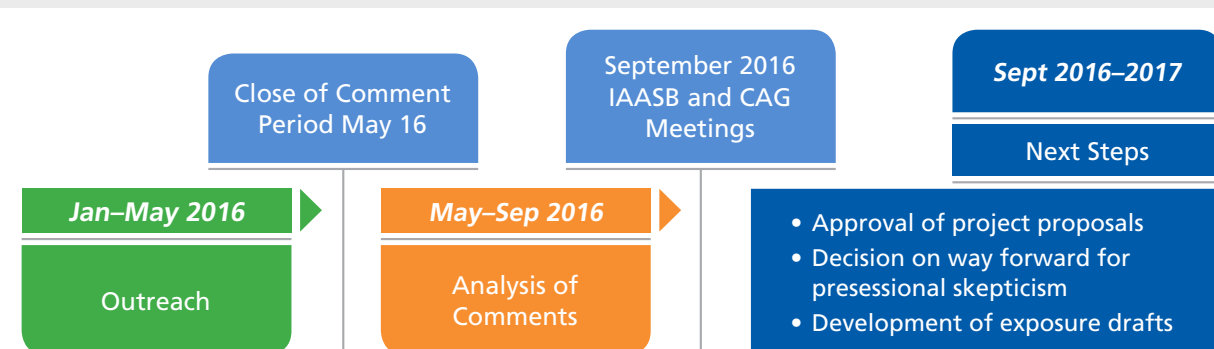
To send us your views in writing, please submit your comments online at this link no later than **May 16, 2016**. All responses will be published on our website.

We also plan to supplement our outreach program with additional events focused on this consultation. In addition, we plan to make available resources and tools to help facilitate responses to this consultation. For more information on events, to find resources and tools for responding, or to notify us of events your organization may be planning, visit www.iaasb.org/focus-audit-quality or contact us at IAASBcommunications@iaasb.org.

What happens next?

Your input will help us decide on our next steps. We intend to use your responses as the basis for moving forward as quickly as possible. We plan to decide on next steps later in 2016, including tabling project proposals for approval. Once we do so, we will start preparing exposure drafts of potential changes to selected standards – with a focus on those relating to quality control and group audits. We will also determine how we should progress actions related to professional skepticism, including in conjunction with our planned standard-setting activities on quality control and group audits.

Key aspects of our expected timeline for the three projects (quality control, group audits and professional skepticism) are as follows:



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Our Standards Frequently Mentioned in this Publication

- International Standards on Auditing™ (ISA™)
- International Standard on Quality Control™ (ISQC™ 1), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*
- ISA 210, *Agreeing the Terms of Audit Engagements*
- ISA 220, *Quality Control for an Audit of Financial Statements*
- ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*
- ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*
- ISA 200, *Overall Objectives of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing*
- ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatements through Understanding the Entity and its Environment*

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WHAT IS DRIVING OUR AREAS OF FOCUS?

- 1 The ISAs and ISQC 1 are fundamental in supporting high-quality audits, which in turn builds public trust and confidence in financial statements. This will be achieved by consistent implementation of our standards around the world. We need to know if our public interest aims are being achieved.

The primary output of an audit is an auditor's opinion that provides users with confidence as to the reliability of the audited financial statements. For the majority of users, the absence of a modified auditor's opinion is an important signal about the reliability of the financial information.

- Paragraph 20 of the IAASB's Framework for Audit Quality (2014)

- 2 Our efforts to clarify the ISAs and ISQC 1 represented a big step in our commitment to audit quality. The clarified ISAs and ISQC 1 became effective in 2009. Soon afterwards, we began our first post-implementation review (the ISA Implementation Monitoring Project), which was completed in July 2013.
- 3 We continue to work closely with our stakeholders to understand where we should focus our future efforts and why – and now we seek your views in determining our way forward.

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ACTIVITIES THAT HAVE INFORMED US

IAASB's ISA Implementation Monitoring project

The July 2013 [findings from the ISA Implementation Monitoring project](#)³ reflect the experience of **firms, NSS, professional accountancy organizations** and others with implementing the clarified ISAs and ISQC 1, as well as input from **audit inspection bodies** and **regulators**. The findings showed the need for us to make some improvements to our standards to achieve more consistent and effective application.

Ongoing Outreach

As part of our rigorous outreach program, we are collaborating with **audit inspection bodies and regulators**. We also talk and listen to **firms, NSS** and others. All this tells us where we may need to act to improve standards or auditor performance. We have stepped up our efforts to reach **investors, audit committees and preparers** to better understand their expectations of auditors and of us.

Public consultation on *IAASB's Strategy for 2015–2019* and *Work Plan for 2015–2016*

*IAASB's Strategy for 2015–2019*⁴

The IAASB's Strategy sets out three strategic objectives. The first, and most important, is to **ensure that the ISAs continue to form the basis for high-quality, valuable, and relevant audits conducted worldwide by responding on a timely basis to issues noted in practice and emerging developments**.

*IAASB's Work Plan for 2015–2016*⁵

Our public consultation on our current Work Plan highlighted our commitment to addressing significant findings from the ISA Implementation Monitoring project on a timely basis. Respondents to the consultation urged us to do so in the public interest. Their input was the basis for our choice of projects. With the strategic objectives in mind, we gave priority to:

- The three topics explored in this consultation – **professional skepticism, quality control, and group audits**; and
- Special considerations in audits of financial institutions (including a potential revision of our standard that deals with auditing accounting estimates).

Prioritizing Work on Auditing Accounting Estimates

While we will continue to consider issues relevant to audits of financial institutions, we have decided it would be in the public interest to focus more broadly on auditing accounting estimates. We have already begun to assess the need for enhanced requirements and better guidance for auditors, and have approved a project proposal at our December 2015 meeting to commence standard-setting actions. We think it is essential to quickly make progress in this area in light of developments in financial reporting standards, and will continue to dedicate resources in 2016 to doing so. However, this publication does not explicitly address that project, although certain aspects of it are highlighted due to the links to professional skepticism, quality control and group audits.

³ www.iaasb.org/publications-resources/clarified-isas-findings-post-implementation-review

⁴ www.iaasb.org/publications-resources/iaasb-strategy-2015-2019

⁵ www.iaasb.org/publications-resources/iaasb-work-plan-2015-2016

WHAT ARE THE MOST RELEVANT PUBLIC INTEREST ISSUES AND HOW CAN WE TAKE ACTION?

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- 4 While we are committed to fully exploring the three topics, we will be successful if we fully understand what you believe needs to be addressed in the public interest. We have identified key public interest issues and have been asking ourselves questions to frame these issues. Our views are set forth in the following table.

Table 1: Our Views on the Most Relevant Public Interest Issues Related to Professional Skepticism, Quality Control and Group Audits

- **Fostering an appropriately independent and challenging skeptical mindset of the auditor** – Professional skepticism is a fundamental concept and core to audit quality. Can we better articulate how we and others expect auditors, especially engagement partners, to appropriately apply professional skepticism? Can the concept be reinforced more within the ISAs, or through other activities by us or others?
- **Enhancing documentation of the auditor's judgments** – How might an audit file more appropriately demonstrate the auditor's decision-making processes, essential interactions and communications, in order to support the auditor's judgments and the audit opinion overall? How can the application of professional skepticism be better evidenced?
- **Keeping ISAs fit for purpose** – Do the ISAs contain robust, yet sufficiently flexible, requirements and guidance to drive appropriate engagement partner and engagement team performance, regardless of the circumstances? Do they promote audit quality at the engagement level in the varied and complex scenarios that arise today, and that are likely to evolve in the future? For example, how can we improve the ISAs to enhance the quality of multi-national audits, considering possible challenges arising from law or regulation (including mandatory auditor rotation) and the use of evolving audit delivery models (ADMs)?
- **Encouraging proactive quality management at the firm and engagement level** – Could we improve audit quality by taking a fresh look at our quality control standard for firms? What can be done to encourage a scalable and robust approach to quality that is fostered by proactive firm leadership and management, and becomes a pervasive aspect of the firm's culture and strategy? How can important processes like engagement quality control (EQC) reviews and processes to respond to internal and external inspection findings be strengthened in our standards?
- **Exploring transparency and its role in audit quality** – Transparency reporting is increasing globally. How could investors and other financial statement users obtain greater insights into a firm's system of quality management (e.g., through firm-level transparency reporting or other mechanisms to demonstrate the application of effective quality management at the engagement level)?
- **Focusing more on firms (including networks) and their internal and external monitoring and remediation activities** – Should our standards more explicitly address expected actions to remediate audit deficiencies or inspection findings? Would audit quality improve if we enhanced requirements as to how firms communicate internally and with other network firms and how they respond to internal and external inspection findings across the network? How can we safeguard against firms relying on network policies and procedures when it is not appropriate to do so?
- **Reinforcing the need for robust communication and interactions during the audit** – Are there opportunities to strengthen our standards in relation to interactions and communication among those involved in an audit? This might affect, for example, interactions between engagement partners, their teams, and others involved in the audit, or between group engagement teams and component auditors – as well as communications with audit committees.

QUESTIONS FOR YOU

It is important that we hear from our stakeholders about what they believe are the root causes of audit quality issues (including those raised in inspection findings) and whether our potential actions are likely to be responsive to these issues. The questions for this ITC can be found on pages 87–95.

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AUDIT QUALITY: WHAT DO WE MEAN AND HOW CAN IT BE ENHANCED?

How are quality audits achieved?

The term **audit quality** encompasses the key elements that create an environment which maximizes the likelihood that **quality audits** are performed on a consistent basis.

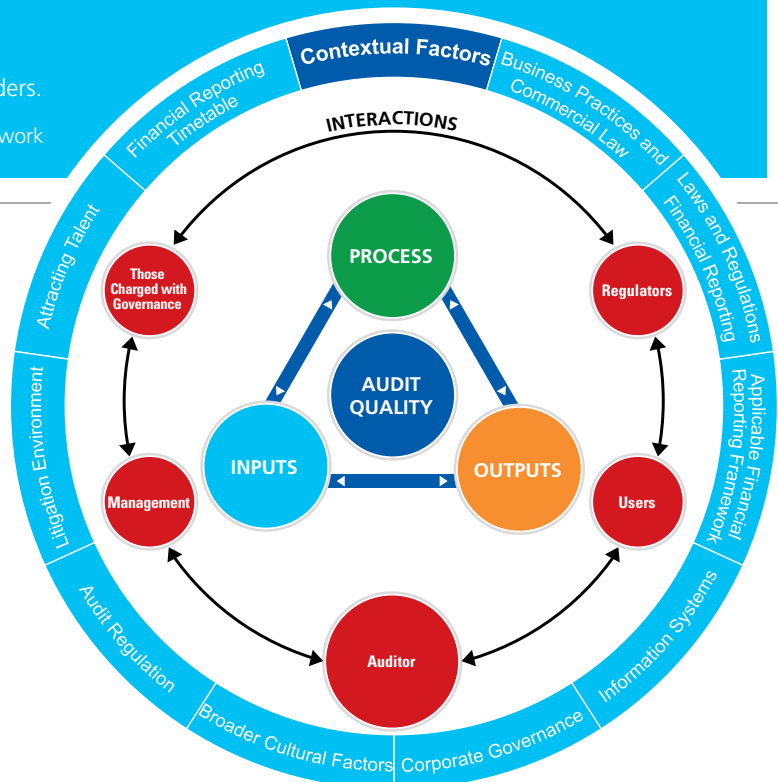
The objective of an audit of financial statements is for the auditor to form an opinion on the financial statements based on having obtained sufficient appropriate audit evidence about whether the financial statements are free from material misstatement and to report in accordance with the auditor's findings. A quality audit is likely to have been achieved by an engagement team that:

- Exhibited appropriate values, ethics and attitudes;
- Was sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the audit work;
- Applied a rigorous audit process and quality control procedures that complied with law, regulation and applicable standards;
- Provided useful and timely reports; and
- Interacted appropriately with relevant stakeholders.

- Paragraphs 1–2 of the AQ Framework

5 The IAASB's *Framework for Audit Quality*⁶ (the AQ Framework) was developed to:

- Raise awareness of the key elements of audit quality.
- Encourage stakeholders to explore ways to improve audit quality.
- Facilitate dialogue between key stakeholders⁷ - acknowledging the shared goal of improving audit quality.



⁶ www.iasb.org/publications-resources/framework-audit-quality-key-elements-create-environment-audit-quality

⁷ In the graphic, "those charged with governance" means the people responsible for overseeing strategic direction of the entity and obligations related to its accountability. That includes overseeing the financial reporting process. Examples of those charged with governance are Boards of Directors and Audit Committees. Governance structures vary, reflecting influences such as different cultural and legal backgrounds, size and ownership.

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- 6 Primary responsibility for audit quality rests with auditors, but each stakeholder plays an important role in supporting high-quality financial reporting. The AQ Framework highlights important inputs, processes and outputs. In quality audits, auditors apply rigorous processes and quality control procedures that comply with law, regulation and standards.
- 7 In recent years, audit oversight bodies have become more active and internationally cooperative. They have intensified inspections, and their publicly reported inspection findings highlight aspects of the audit where improvements to audit quality are needed. For example, in 2014, the International Forum of Independent Audit Regulators – IFIAR – reported persistent deficiencies in important aspects of audits, including the three topics addressed by this consultation.
- 8 We have begun exploring where specific standards could be enhanced. Making changes to our standards in key areas – with the goal of strengthening auditor performance – is one way to enhance audit quality. For example, in addition to considering enhanced engagement-level requirements, our planned work on firms’ system of quality control should help firms increase the prospect of delivering quality audits and expressing appropriate opinions.

While IFIAR recognizes that inspection findings do not on their own mean that changes are necessarily needed to the standards, IFIAR comment letters encourage the international standard setters [such as the IAASB] to pursue their efforts to consider the themes identified by IFIAR’s inspection surveys in defining and conducting its standard-setting projects, with a perspective towards identifying how the international standards might further contribute to improving the quality of the audits globally. IFIAR believes these areas where the IFIAR Survey reports audit deficiencies, especially where those findings are numerous or recurring, deserve the specific attention in the international standard setters’ processes. IFIAR believes further investigation in those areas, with a perspective to evaluate if and how standards could contribute to prevent a recurrence of those findings in audit firms and audit engagements, would be beneficial to their relevance.

- IFIAR 2014 Summary of Inspection Findings⁸

- 9 Broader environmental factors – referred to in the AQ Framework as “contextual factors” – have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality. As countries develop, growing businesses need finance from capital markets, and the environment becomes more complex. Decision-makers need and expect reliable financial reporting. In response, law, regulation, financial reporting requirements and corporate governance processes continue to develop and adapt. The evolving business environment and increasing complexity can challenge those who must prepare high-quality financial statements and related disclosures, as well as those who oversee their preparation. Those who oversee these tasks, such as audit committee members, are also affected by change and complexity.
- 10 The following contextual factors and developments are particularly relevant to our efforts:
 - **Business practices and commercial law** – Law or regulation may create tax or other incentives based on domicile. These may influence how entities are structured. Entities are also increasingly using shared service centers (SSC) to improve effectiveness and efficiency.
 - **Laws or regulations relating to financial reporting and the applicable financial reporting framework** – Financial reporting frameworks increasingly require significant management judgment and use of forward-looking information as the basis for recognition or measurement, and expect this information to be disclosed in the financial statements.
 - **Information technology** – Technological change is occurring at a rapid pace, ushering in the capability to capture and communicate data digitally, on an unprecedented scale and on almost instantaneous timescales. This has resulted in increasing focus on “big data,” whether structured or unstructured. Comprehensive and powerful digital information systems are increasingly capable of handling, analyzing, communicating and responding to these data related changes. Businesses are rapidly changing their business models in innovative ways in response to these developments. These changes are feeding into the information systems for financial and broader corporate reporting, and therefore have implications for audits. Audits are also increasingly being conducted using advanced technologies, including the evolving use of audit data analytics.

⁸ www.ifiar.org/IFIAR/media/Documents/General/IFIAR%20Global%20Survey%20Media%20Coverage/IFIAR-2014-Survey-of-Inspection-Findings.pdf

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- **Corporate governance** – Audit committees are important in enhancing audit quality. Reflecting this, audit committees are being called on to play a more active role on behalf of investors and other external stakeholders;⁹ not only in overseeing the financial reporting process, but also their oversight of, and interactions with, auditors. In particular, external stakeholders expect audit committees to challenge auditors' judgments.
- **Audit regulation** – Increasingly, inspections of audits of listed entities must be done by independent audit regulatory bodies. Audit inspections are important for evaluating auditors' compliance with auditing standards and, in some cases, other aspects of audit quality. Inspections can identify weaknesses which firms are then expected to address.
- **Attracting talent** – Auditing is a demanding intellectual activity requiring good judgment, an questioning mind, fortitude, and business, financial reporting and auditing knowledge. The changing business and regulatory environment has led to challenges for auditors, and has affected how audits are carried out. This is perhaps most extensively experienced in audits of multi-national entities (which are often group audits). As a result, firms are reorganizing their own structures. They are reviewing how best to organize engagement teams and conduct audits to get appropriately skilled and competent personnel to perform high-quality audits at a reasonable cost. Engagement team members may not all work together in the same place, as they might have in the past. Now, they may be in different jurisdictions or time zones. We refer to these evolving models as ADMs – an expression intended to cover terms such as "firm shared service centers," "centers of excellence," "on-shoring," "offshoring," or "outsourcing."

- 11 As we set standards, and with a view to keeping the ISAs fit for purpose, we need to help auditors appropriately react to the challenges of the evolving environment – so that quality audits can be achieved. Our standards need to strike the right balance. They must promote a "thinking audit" yet remain principles-based (and therefore applicable across a wide range of circumstances). But we know robust guidance to help auditors achieve quality audits and deliver against expectations is essential. As an example, some firms have pointed out a need to develop their own guidance for circumstances not expressly addressed in the international standards. Awareness of this material and the rationale for it is useful as we consider what more may be needed within our standards or as non-authoritative guidance or tools that we could develop for use on an international basis.
- 12 Our standards must also be capable of being applied to audits of all types of entities globally. We have been called upon to better support SMPs in applying our standards to audits of smaller or less complex entities, in particular by firms who do not audit listed entities. We are also interested in whether there are specific implications relating to public sector audits that we should consider, given the public interest importance of many public sector organizations (e.g., central banks and other governmental agencies).
- 13 We know we need to address key public interest issues relating to professional skepticism, quality control and group audits on a priority basis. Our international standards need to better address increasing complexity, taking into account the rapidly changing technological developments in both the business and audit environment. Our stakeholders and the public at large have high expectations of audit quality, and the role of auditors – and are looking for us to take action.
- 14 We need to reinforce that auditors will continue to be critical challengers, supported by a regime focused on public interest and quality management. We acknowledge the importance of strengthening our standards and demonstrating responsiveness to concerns about audit quality not being achieved. Taking action will enable us to achieve our strategic objective about global use of our standards. The next sections suggest how we might proceed.

We need to help auditors appropriately react to the challenges of the evolving environment.

QUESTIONS

General Questions G1–G3

⁹ For example, in 2015, the Organisation for Economic Co-operation and Development (OECD) issued revised *Principles of Corporate Governance*. These were endorsed by the G20 Finance Ministers. They also formed the basis for guidelines on banks' corporate governance issued by the Basel Committee on Banking Supervision. Audit committees may also be required to report externally on how they discharged their responsibilities (as happens, for example, in the UK).

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HOW CAN WE STRENGTHEN THE APPLICATION OF PROFESSIONAL SKEPTICISM IN AUDITS?



- 15** How can we reinforce the fundamental concept that auditors need to apply appropriate professional skepticism throughout the audit? This question is at the core of the IAASB's efforts to improve audit quality

How Our Standards Address Professional Skepticism

ISA Definition: An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.¹⁰

Our standards explicitly recognize the fundamental importance of professional skepticism. Professional skepticism includes being alert to, for example, audit evidence that contradicts other audit evidence obtained, or information that brings into question the reliability of documents or responses to inquiries to be used as audit evidence. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence.¹¹

The **February 2012 IAASB Staff Questions and Answers publication**¹² focuses on considerations in our standards that are of particular relevance to the proper understanding and application of professional skepticism. Amongst other matters, it discusses:

- What firms and auditors can do to raise awareness of the importance of professional skepticism;
- Aspects of an audit where professional skepticism may be particularly important; and
- How professional skepticism can be evidenced.

- 16** In conducting an audit in accordance with ISAs, the auditor is required to apply professional skepticism – recognizing that circumstances may exist that may cause the financial statements to be misstated. Professional skepticism is essential in all aspects of the audit – from planning and risk assessment through to the critical assessment of audit evidence in forming the auditor's conclusions. We believe it is in the public interest to explore what can be done to re-emphasize the important role of professional skepticism in audits of financial statements.

¹⁰ ISA 200, paragraph 13(l)

¹¹ See ISA 200, paragraphs A18 and A21.

¹² www.iaasb.org/publications-resources/staff-questions-answers-professional-skepticism-audit-financial-statements

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- 17** Investors, regulators and other stakeholders expect auditors to challenge management's assertions, including when management has used an expert to help prepare financial statements. Unless auditors do so, they cannot appropriately plan and perform an audit – nor can they conclude, with confidence, whether an entity's financial statements are fairly presented in accordance with the applicable financial reporting framework.
- 18** Concern about instances in which auditors did not appropriately apply professional skepticism in their audits is a globally recurring theme in audit inspection findings, and has been central to our discussions about audit quality. IFIAR has suggested that enhanced professional skepticism by auditors will contribute significantly to improving the quality of audits and that firms should prioritize efforts in this area.

The PIOB noted that professional skepticism, as a state of the mind and attitude, should govern the performance of auditors, and inspire the attitude of other accountants, e.g., accountants in business. When accountants (practitioners, non-practitioners, accountants in business) do not display proper professional skepticism it is recognized as a barrier to effective performance.

- September 2014 [Conclusions from the PIOB Public Interest Workshop](#)¹³

- 19** We are seeking to understand what our stakeholders think about the “root causes” of these inspection findings, including their views about why auditors are not, or do not appear to be, appropriately applying professional skepticism. In particular, we want to know how auditors in practice are able to conclude that they have appropriately applied professional skepticism.
- 20** Questions have also been raised about how auditors can more clearly demonstrate the application of professional skepticism, in particular how to better describe the basis for the auditor's professional judgments and conclusions and how the auditor's mindset has affected the nature, timing and extent of audit procedures performed.
- 21** We have noticed that research studies sometimes describe the concept of professional skepticism in a manner that differs from how the concept is defined and addressed in the ISAs. For example, some studies describe the application of professional skepticism by referring to outcomes such as auditors assessing certain accounts as more susceptible to risk, obtaining more evidence or explicitly searching for inconsistent evidence, challenging management's judgments, or investigating differences between management's and the auditor's judgments.
- 22** The existence of various ways to describe the application of professional skepticism indicates that the concept of professional skepticism, and the expectations of how auditors should appropriately apply it, may need to be more clearly articulated in our standards.

¹³ www.iaasb.org/system/files/meetings/files/Agenda%20Item%201-C%20-%20PIOB%20Sept%202014%20Public%20Interest%20Workshop%20Conclusions.pdf

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- 23** The topic of professional skepticism is addressed in the IAASB's standards and is also touched on in the International Accounting Education Standards Board's (IAESB) International Education Standards (IESs) and the International Ethics Standards Board for Accountants' *Code of Ethics for Professional Accountants* (IESBA Code), referred to collectively in this consultation as the International Standards. The table below depicts the concepts in the IESs and the IESBA Code that are relevant to the application of professional skepticism in audits.

Relevant Concepts in the IESs

- Technical competence for professional accountants
- Professional skills
- Professional development, including with respect to values, ethics and attitudes

Relevant Concepts in the IESBA Code

- Integrity
- Objectivity
- Independence of mind
- Professional competence and due care
- Professional behavior

Professional Skepticism, Professional Judgment and Documentation

- 24** The concepts of professional skepticism and professional judgment are closely related, and together are key inputs to audit quality. Professional skepticism often facilitates the appropriate exercise of professional judgment by an auditor. Similarly, the application of professional skepticism requires professional judgment. Both concepts are essential to the auditor's decision-making.
- 25** Professional judgment is defined in the ISAs as the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about appropriate actions in the audit engagement.¹⁴ The application of professional skepticism is especially important in the context of audit work on those areas of the financial statements that are highly judgmental or subjective – areas that are influenced, for example, by recent developments in financial reporting standards.
- 26** While professional skepticism is an attitude, this attitude is applied in making professional judgments that provide the basis for auditors' actions. The documentation of professional judgments made, and actions taken, may provide evidence that professional skepticism was applied. The diagram to the right is a simple illustration of how professional skepticism drives action. Other relevant concepts in accounting, auditing and ethical requirements, including independence of mind, objectivity, and competence, as well as firm-specific and environmental factors may impact the application of professional skepticism.
- 27** Documentation of professional judgments and actions provides evidence that professional skepticism was applied. The ISAs require auditors to document discussions of significant matters with management, those charged with governance and others, including the nature of the significant matters discussed and when and with whom the discussions took place.¹⁵ We have heard that the additional reporting requirements in the new and revised Auditor Reporting standards, in particular, new ISA 701¹⁶ may serve to improve documentation of professional judgments made during the audit, thereby better evidencing the application of professional skepticism.

How Professional Skepticism Drives Action

Professional skepticism
is an attitude

Professional skepticism
is applied in making
professional judgments

Professional judgments
prompt actions

Documentation of
professional judgments
and related actions

¹⁴ ISA 200, paragraph 13(k)

¹⁵ See ISA 230, *Audit Documentation*, paragraph 10.

¹⁶ New ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, will soon be effective, and will require auditors to communicate key audit matters in the auditor's report for audits of financial statements of listed entities. Key audit matters are defined as those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance. See www.iaasb.org/new-auditors-report.

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- 28** Adopting and applying a skeptical mindset is a personal and professional responsibility for every auditor. The application of professional skepticism is influenced by personal traits, including fortitude (i.e., the strength of mind that enables the auditor to deal with matters arising during the course of the audit with courage), and the auditor's competence (e.g., knowledge, skills and experience).
- 29** Individual behavior, (including an auditor's), is also influenced by inherent cognitive biases as well as by external factors (such as familiarity threats). Questions have been raised about whether the existing client service relationships, in particular long-term ones, and the payor model affect auditors' ability to appropriately apply professional skepticism. Some stakeholders have asked whether situations arise where auditors unduly accept the fact that management is honest and prepares the financial statements accurately.
- 30** Firms also have an important role to play in cultivating a skeptical mindset in auditors. This includes designing and implementing policies, procedures and incentives that promote a culture that recognizes and reinforces professional skepticism as being essential – and therefore expected as audits are conducted. A firm's approach to training its auditors, including mentoring, reflective activity and practical on-the-job training, may also enhance the effective development of professional skepticism. Firms' policies and procedures may also focus on how to reward or incentivize auditors who demonstrate skeptical behavior. In addition, effective performance of EQC reviews may contribute to the appropriate application of professional skepticism.
- 31** It is important to acknowledge, however, that other factors related to the audit can inhibit auditors' application of professional skepticism. Examples of such factors include tight financial reporting deadlines, and heavy staff workloads, as well as time and resource constraints more generally. Our stakeholders have suggested that auditors may approach an audit with a skeptical mindset at first, and appropriately identify issues that need attention, but may not always apply professional skepticism in following through with appropriate actions (i.e., revising risk assessment, designing and performing responsive audit procedures or properly documenting their findings and conclusions). This may ultimately call into question whether professional skepticism was appropriately applied in the audit.
- 32** Environmental and contextual factors can also affect the application of professional skepticism. These include the business environment, laws and regulations, as well as the local norms and culture in which an auditor operates. For example, we have learned from discussions with stakeholders that auditors in certain jurisdictions may be less comfortable challenging management when auditing areas in the financial statements that are highly judgmental or subjective.
- 33** Outreach and research suggests that firms, NSS, and others are well-positioned to take on initiatives to assist in addressing the concerns that have been raised about professional skepticism. We have identified those parties as "direct influencers" (listed in the box to the right). We believe that the "direct influencers", in particular audit committees, have a significant role to play in challenging and questioning the auditor's application of professional skepticism.

Stakeholders who can directly influence professional skepticism

- Firms/Networks of firms
- Standard setters, including NSS
- Professional accountancy organizations
- Educational institutions
- Those charged with governance, including audit committees
- Regulators and audit oversight bodies
- Management/those responsible for preparing the financial statements

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- 34 NSS and professional accountancy organizations, educational institutions and others can positively influence the training and education of auditors, thereby developing and promoting the necessary competence to apply professional skepticism and raising awareness of the factors that may inhibit its appropriate application.

OUR PRELIMINARY VIEWS ON A POSSIBLE WAY FORWARD

- 35 We raised the possibility of undertaking work on professional skepticism in our consultation on our Strategy for 2015–2019 and current Work Plan. Stakeholders who responded to this consultation acknowledged the complexities and challenges we would face in addressing this topic. In general, respondents did not support a discrete standard-setting project leading to changes to ISAs as the primary or only response to the concerns and issues that have been identified. Rather, they suggested that it would first be necessary for us to further explore behavioral, training and other issues in order to have a better basis for understanding what more we and others could do in this area.
- 36 We are committed, in the public interest and with an open mind, to delving into this complex subject. We want to find meaningful actions that we and others could take to enhance the application of professional skepticism – in a way that takes into account personal traits and their influence on auditor behavior and the importance of developing auditor competencies, recognizing that external factors or barriers will continue to exist.

Our Activities to Date

- [Feedback from the consultation](#)¹⁷ on our *Strategy for 2015-2019* and *Work Plan for 2015-2016*
- Professional Skepticism [Panel Discussion](#)¹⁸ hosted during our June 2015 meeting
- Feedback provided by the IAASB Consultative Advisory Group (CAG) at its [September 2015 meeting](#),¹⁹ following a presentation from an academic specializing in professional skepticism
- Consideration of conceptual issues related to professional skepticism during our [September 2015](#)²⁰ meeting
- Summary of academic research on professional skepticism undertaken in 2013–2015 and related discussion at our [December 2015 meeting](#)²¹
- Incorporating discussion of professional skepticism into our outreach and liaison activities with a wide range of stakeholders

Areas Being Explored

- 37 We believe that responding to the concerns raised about professional skepticism will involve a coordinated approach by the IAASB, IAESB and IESBA. Accordingly, a [Joint Working Group](#) of representatives from these boards is exploring the following areas to inform our deliberations, including:
- Whether it is clear what is meant by “professional skepticism” and whether the concept is consistently described across the ISAs, IESs and IESBA Code – for example, whether the links between the term professional skepticism and other concepts (such as professional judgement, integrity, independence of mind, objectivity, and sufficient appropriate audit evidence) are clear and well-understood.
 - Whether the current requirements and guidance in the International Standards that refer to professional skepticism are clear as to what is expected from auditors, including:

¹⁷ <http://www.iaasb.org/publications-resources/basis-conclusions-iaasb-work-plan-2015-2016>

¹⁸ <http://www.iaasb.org/news-events/2015-06/professional-skepticism-panel-discussion>

¹⁹ <http://www.iaasb.org/cag/meetings/new-york-usa-0>

²⁰ <http://www.iaasb.org/meetings/new-york-usa-10>

²¹ <http://www.iaasb.org/meetings/new-york-usa-11>

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- Whether the manner in which requirements in the International Standards, in particular those that address the audit of highly judgmental or subjective areas, are designed effectively and use appropriate terminology and language to drive appropriate auditor behavior.
- Whether guidance can be developed to support auditors in their consideration of whether they have appropriately applied professional skepticism in the context of an individual engagement – for example, has enough of the right kind of work been done, and at the right time, as a basis for the auditor's conclusions?
- Whether there is a need for clarification in the ISAs about what constitutes evidence of the application of professional skepticism and how auditors should document the application of professional skepticism in their working papers.
- Whether there are specific actions that firms should take to address professional skepticism, including consideration of the effect of firm culture on the application of professional skepticism.
- How auditors can be effectively trained and how their competencies can be further developed to enhance the application of professional skepticism.
- How the International Standards should recognize and address the nature of auditors' personal traits and biases that may inhibit the appropriate application of professional skepticism.
- How the technical nature of these concepts can be better brought to life in the auditor's understanding of the purpose of an audit and with respect to stakeholders' expectations about how professional skepticism is to be applied.
- The potential effect of evolving use of technology in audits, together with increasing business complexity, for example, whether auditors use technology (such as audit software applications and checklists) appropriately to support the application of professional skepticism.
- The role of engagement partners, EQC reviewers, audit committees, audit oversight bodies and others in influencing the appropriate application of professional skepticism.
- How the local norms and culture impact the application of professional skepticism.
- Whether a professional skepticism framework or a professional judgment framework that focuses on professional skepticism (a topic already explored by some firms) should be developed.

We plan to emphasize the importance of professional skepticism in revising specific standards.

Our Current Projects – A Step Forward

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We believe our current efforts on quality control and group audits, as well as our project on accounting estimates, provide opportunities to reinforce the concept of professional skepticism. Our efforts related to quality control and group audits are described in this consultation, for example:

- (a) How firm leadership responsibility and accountability (i.e., "tone at the top"), firm culture and strategy, as well as actions by the engagement partner, can better promote the application of professional skepticism in audits (see paragraphs 125–135). For example, we will explore:
 - (i) How to reinforce that quality is essential in performing audits and highlight the importance of an internal culture that sets expectations for the appropriate application of professional skepticism throughout the audit, and allows engagement team members to raise concerns without fear of negative consequences.
 - (ii) How a firm's policies and procedures reward and incentivize auditors who demonstrate skeptical behavior in performing audits.
- (b) Steps that could be taken to better encourage appropriate application of professional skepticism with respect to judgments made by the group engagement partner and group engagement team in a group audit, including more robust interactions and communications with component auditors (see paragraphs 198, 201, 242, 288 and 299).

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- 39** As part of its work to revise ISA 540, we will seek to stress the importance of professional skepticism and its role in making professional judgments in relation to the auditing of accounting estimates that are complex or have been identified as having high estimation uncertainty. These accounting estimates generally involve significant management judgment and therefore there is an increased risk of unintentional or intentional management bias. In this regard, consideration could be given as to how the requirements in ISA 540 are drafted, with a view to making amendments that improve the focus on auditors approaching accounting estimates with a more questioning mindset rather than one of corroboration. The revised standard could also highlight the need to consider the effect of contradictory audit evidence that comes to the auditor's attention.
- 40** Other areas that could benefit from more emphasis on professional skepticism may emerge from our:
- (a) Information-gathering about the use of audit data analytics.
 - (b) Future projects, such as the project to address issues with the auditor's identification and assessment of risks (ISA 315 (Revised)).

RELEVANT IAESB AND IESBA DEVELOPMENTS

- 41** The IAESB's consultation on its future strategy acknowledges the relevance of the topic of professional skepticism and poses a question to stakeholders about what actions can be undertaken by the IAESB to improve auditors' professional competencies related to the application of professional skepticism.
- 42** The IESBA is actively contributing to the activities of the Joint Working Group, with a view to determining whether there are areas within the IESBA Code where there would be benefit in elaborating on, emphasizing or clarifying ethical considerations relating to professional skepticism in ways that would support and complement the discussion of professional skepticism in the ISAs and the IESs.

HOW YOUR FEEDBACK WILL BE USED

- 43** The Joint Working Group will consider various inputs, including the feedback to this consultation and the IAESB's next steps in developing its future strategy, as well as relevant national developments and the results of academic research. The group will make observations or recommendations for further actions for the standard-setting Boards to consider. These will include whether standard-setting activities may be appropriate and what other potential actions might be necessary in the public interest.
- 44** The Joint Working Group's work, feedback from this consultation, and our planned outreach in 2016 is intended to open the dialogue about these fundamental issues. This input will help us consider whether changes to some of our standards could more directly encourage the application of professional skepticism. We will also consider other appropriate actions that we can take, either alone, or in coordination with others. By late 2016, we expect to be in a position to decide on our way forward.

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HOW CAN WE STRENGTHEN OUR STANDARDS ADDRESSING QUALITY CONTROL?

QUALITY CONTROL – EXTRACT FROM 2015–2016 WORK PLAN

The feedback received by the IAASB in developing its Work Plan for 2015–2016 indicated that there are issues and concerns in the following areas related to quality control:²²

In relation to EQC Reviews—Concerns about the selection of EQC reviewers (in particular, in light of previous inspection findings and competency to carry out such reviews), independence of the reviewer from the engagement team, the professional skepticism exercised by the reviewer; and the other matters relating to the objective, extent and timing, and documentation of the EQC reviewer.

In relation to the IAASB's development of the Framework for Audit Quality and other outreach—Consideration of whether aspects of the Framework may need to be addressed either within the requirements or guidance in ISQC 1 and ISA 220 or, as appropriate, by the IESBA Code,²³ for example:

- Engagement performance (matters relating to consultations, technical reviews of financial statements, engagement acceptance, appointment of engagement team members, independence and ethics, changing resource models (e.g., audit firm use of SSC);
- Human resources (technical competence / capabilities and expertise of the engagement team, including the engagement partner, recruitment and training, remuneration based on audit quality);
- Internal monitoring reviews, including scope and extent;
- Using the work of a specialist and auditor's expert, and the differences between the two;
- Clarification of definitions, such as "professionals", and further guidance on the applicability to public sector audits; and
- Governance structures of firms and networks.

In relation to remediation—Whether there is a need within ISQC 1, or elsewhere in the ISAs, for the IAASB to acknowledge the importance of a firm's system of quality control addressing root cause analysis of significant audit deficiencies that have been identified by external inspections. Regulators suggested that greater consistency in practice by firms to respond to inspection findings in respect of individual audits may be seen as a means to improving audit quality.

In relation to proportionality of ISQC 1 for small and medium practices (SMPs) and applicability to reviews, other assurance and related services engagements—Concerns have been raised that ISQC 1 cannot be proportionately applied by SMPs performing audits, and SMPs and others have also suggested that it could be made more clear as to how ISQC 1 can be applied to reviews, other assurance, and related services engagements.

²² Feedback included the findings from our ISA Implementation Monitoring project, a stakeholder survey on work plan priorities, consultation on our proposed Work Plan for 2015–2016, and input from outreach to key stakeholders.

²³ We will continue to coordinate and collaborate with the IESBA on topics of mutual interest.

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The matters above present a summary of the initial input to the project on quality control as presented in the IAASB's *Work Plan for 2015–2016*. However, in exploring these matters further, and based on our deliberations and input from the IAASB CAG and from outreach activities, our understanding of some of the issues has evolved, and in some cases the issues have been refined or expanded. The description of the matters in the discussion that follows reflects these refinements and expansions.

In considering changes to ISQC 1 and ISA 220, we are also exploring revising ISQC 1 to incorporate the use of a Quality Management Approach (QMA) (described in paragraphs 45–67). A QMA would involve a broader approach to managing quality than the current approach to quality control in extant ISQC 1.

We are particularly interested in further understanding stakeholder views about possible actions that may be taken (including input on our initial views about those actions). In particular, we are interested in understanding whether and how matters may have been or are being addressed (e.g., because firms have developed internal guidance to address certain aspects of the issues) or whether practical challenges continue to be experienced. We are interested in your views about actions related to quality control that may help emphasize professional skepticism and how the possible actions we have described might be enhanced to better emphasize and support the appropriate application of professional skepticism. Additionally, we want to know whether there are any specific implications related to SMPs or public sector considerations regarding the issues identified and possible actions we may take.

When exploring changes to the requirements and application material in the ISAs, we noted that it may be necessary to visit the relevant definitions in ISQC 1 and the ISAs to determine whether changes are needed.

We have organized the matters relating to quality control as follows:

- Introduction and post-implementation feedback on ISQC 1 (see paragraphs 45–49.)
- A new quality management approach (see paragraphs 50–67.)

Crossover Issues / Issues relevant to More than One Project

Quality Control at the Engagement Level

- Engagement partner roles and responsibilities (see paragraphs 69–86.)
- Others involved in the audit (see paragraphs 87–104.)

The Firm's Role in Supporting Audit Quality (see paragraph 105.)

- Quality control considerations when operating as part of a network (see paragraphs 106–116.)
- Exploring the potential effects that firms' changing business models and structures have on audit quality (ADMs) (see paragraphs 117–123.)

Quality Control Specific Matters

- Governance of the firm, including leadership responsibilities for quality (see paragraphs 125–135.)
- Engagement quality control reviews and engagement quality control reviewers (see paragraphs 136–146.)
- Monitoring and remediation (see paragraphs 147–159.)
- Engagement partner performance and rewards systems (see paragraphs 160–170.)
- Human resources (see paragraphs 171–178.)
- Engagement partner competency (see paragraphs 179–187.)
- Transparency reporting (see paragraphs 188–190.)

INTRODUCTION

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- 45** In addition to setting global auditing standards, we also set global quality control standards for firms. Our standard, ISQC 1, provides the foundation for the approach to quality for firms of all sizes. It sets out what we believe is needed in a firm's system of quality control for audits and reviews of financial statements, and other assurance and related services engagements. An effective system of quality control supports consistent quality in all the services a firm provides and is one of the essential components of how a firm manages itself. ISQC 1 requires a firm to develop policies and procedures addressing key elements of a system of quality control. These elements include:

- Leadership responsibilities for quality within the firm
 - Acceptance and continuance of client relationships and specific engagements
 - Monitoring
 - Relevant ethical requirements
 - Human resources
 - Engagement performance
- Paragraph 16 of ISQC 1

- 46** ISA 220 complements ISQC 1 by addressing quality at the engagement level – that is, for each audit. ISA 220 is premised on the basis that the firm is subject to ISQC 1 or to national requirements that are at least as demanding as ISQC 1.

- 47** In the wake of the financial crisis, many companies have responded to the changing environment and emerging corporate governance risks by revisiting their business practices and relevant activities. As the environment in which firms operate evolves and the focus on quality intensifies, questions have arisen about whether ISQC 1 could be revised to adopt more robust requirements – more explicitly and better addressing certain matters.

POST-IMPLEMENTATION FEEDBACK ON ISQC 1

- 48** Further, our ISA Implementation Monitoring project identified concerns related to applying ISQC 1. Regulators and audit oversight bodies have urged us to take steps to improve the standard in terms of what they expect from firms, in particular in relation to:
- (a) More direct firm leadership responsibility and accountability for quality. Firm leadership needs to set an appropriate “tone at the top” to focus the firm and its personnel on continually achieving and enhancing quality;
 - (b) Understanding causal factors of findings from both external and internal inspections. Firms are also expected to take action to respond to these findings, referred to as remediation or remedial actions;
 - (c) Monitoring the effectiveness of those remedial actions and making adjustments to them if they are not achieving the desired results; and
 - (d) Establishing a more explicit link between accountability for quality within policies and procedures addressing human resource matters (e.g., recruitment, retention, training and remuneration).
- 49** Some of our stakeholders, in particular some SMPs, see ISQC 1 as having a “one size fits all” approach to quality control. They have encouraged us to think about how we can improve the standard to deal with differences in the size and nature of the firm or its services.

A NEW QUALITY MANAGEMENT APPROACH

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Introduction

- 50 We have to find a way to respond to the diverse challenges raised – how to improve the standard while acknowledging its application by firms of all sizes and to engagements other than audits. Considering the feedback received, we support what we call a new QMA. The approach we propose would emphasize the responsibility of firm leaders for a more proactive, scalable and robust response to managing quality risk that would more easily adapt to a rapidly changing business environment.
- 51 To meet the objectives of ISQC 1, firms today apply many different policies and procedures, which vary depending on the firm's circumstances. Some firms may have already moved towards using more proactive approaches to managing quality – as they have been challenged to focus more on particular elements of their system of quality control as a result of external inspection findings.
- 52 A QMA would integrate a firm's policies and procedures within its system of quality control through identification of relevant risks to quality and design of appropriate policies and procedures to address those risks. This consultation provides an opportunity to obtain views and further input to assist us in moving forward with a revision of ISQC 1, including the possibility of incorporating a QMA in ISQC 1.
- 53 Revising ISQC 1 to incorporate the use of a QMA may provide us with the opportunity to provide guidance as to how firms might, in appropriate circumstances, consider whether and how corporate governance principles may be helpful or relevant in the context of identifying, assessing and responding to quality risks.²⁴
- 54 While retaining robust requirements, incorporating a QMA into ISQC 1 (discussed further in paragraphs 59–66) would involve a broader revision and restructure of ISQC 1 and not just targeted amendments to specific requirements and guidance. In reconsidering the structure of the standard, we will concurrently address the specific issues and concerns with the current quality control requirements discussed in paragraphs 68–190 potentially strengthening the requirements and enhancing the application material in the standard.
- 55 A redesign of our quality control standards also gives us a chance to further demonstrate how the management of quality is scalable, especially for firms that do not audit listed entities (or perform audits at all).
- 56 We believe that requiring a QMA would help firms in designing and implementing effective quality management systems that:
 - (a) Take account of the size and nature of the firm, the services the firm provides, and the nature of the entities to whom those services are provided, and
 - (b) Are flexible enough to take account of changes in the firm's environment.
- 57 ISA 220 could also be revised for the adoption of a more proactive, scalable and robust approach to audit quality at the engagement level. For example, there may be a need in ISA 220 to establish more explicit requirements for the engagement partner to more proactively manage quality risks at the engagement level.
- 58 We will also consider the implications of a QMA at the firm level for group audits. For example, the existence of a firm-level QMA may impact the engagement-level considerations about acceptance and continuance of group audits.

We are exploring the use of a QMA by firms to more proactively focus on quality, including risks to achieving quality.

²⁴ For example, the OECD *Principles of Corporate Governance* include principles in priority areas such as remuneration, risk management, board practices and the exercise of shareholder rights.

Incorporating a QMA into ISQC 1**Agenda Item 8.
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A QMA would increase the focus in ISQC 1 on the importance of and need for effective firm leadership as a foundation to the ability of the firm to achieve quality at all levels. Specific requirements may address the need for:

- (a) Creating the appropriate culture and tone within the firm, including a focus on leadership accountability for quality and the important role leaders in the firm have in this regard; and
- (b) Setting the basis for how the risk of not meeting the firm's quality objectives (referred to as quality risk) is viewed and addressed by the firm and its personnel, which includes consideration of integrity and ethical values and the environment in which the firm operates.

Table 2. Some of the areas to be explored in considering changes to ISQC 1, how they are currently dealt with in ISQC 1 and how they might be addressed under a QMA are illustrated in the table below.

ISQC 1		
Key Areas to Be Explored	Extant	QMA
Risk(s) of not achieving quality objectives	<p>Emphasis on standardized assumptions regarding the risks of a firm not meeting its quality objectives and a standardized approach to a firm's system of quality control that may not always fit with a firm's particular circumstances or sufficiently facilitate adapting to an evolving environment. As noted in our October 2012 Staff Q&A publication,²⁵ ISQC 1 deals with the appropriate application of ISQC 1 to consider the circumstances of the firm. For example:</p> <ul style="list-style-type: none"> • Paragraph 14 of ISQC 1 requires firms to comply with each requirement in ISQC 1 unless, in the circumstances of the firm, the requirement is not relevant to the services provided. • Paragraph 15 of ISQC 1 notes circumstances vary widely and all such circumstances cannot be anticipated, therefore a firm may need to establish policies and procedures in addition to those required by ISQC 1 to meet the stated objective. 	<p>While retaining robust requirements, ISQC 1 would describe the actions to address the requirements, on the basis of requiring the firm to design and implement appropriate responses to quality risks. The firm's risk identification process would take into account the evolving environment in which the firm operates, such as financial reporting framework developments, evolution in business models as technological development continues at a rapid pace, the firm's ADMs and innovation in audit data analytics.</p>
Monitoring quality from all sources	<p>ISQC 1 includes requirements related to monitoring, but with a focus on results from internal inspections and peer reviews.</p>	<p>A QMA would promote the need for consideration of all feedback on quality, including from inspections (internal and external) and peer reviews, but also from other kinds of monitoring that a firm may perform such as pre-issuance and post-issuance reviews (see paragraph 148). A QMA would more clearly address that monitoring of the effectiveness of remedial actions to address identified deficiencies is critical to continually enhancing quality, placing greater emphasis on achieving a quality outcome prior to the issuance of a deliverable.</p>
Conditional requirements	<p>Few conditional requirements (i.e., requirements that only apply in particular circumstances).</p>	<p>Increased use of conditional requirements could result from enhanced focus on a firm's individual circumstances in setting quality objectives, assessing related quality risks and designing effective responses. For example, additional requirements may be identified as necessary for firms that audit listed entities or other entities of particular public interest, or to acknowledge the effects of law or regulation.</p>
Scalability	<p>Individual requirements do not contain detailed explanatory material that could assist firms of all sizes and with all different types of practices in designing appropriate policies and procedures in light of the relevant facts and circumstances.</p>	<p>Scalability could be embedded in a QMA. For example, factors to consider could be embedded in specific requirements to support achievement of quality objectives. Firms would be expected to apply such factors in identifying risks and in determining the nature and extent of responsive policies and procedures. This approach could explicitly acknowledge that responsive policies and procedures would likely vary depending on the nature and assessment of the related risks of the firm not achieving its quality objectives, benefiting firms of all sizes.</p>
Audit and non-audit context	<p>ISQC 1 viewed as largely applicable for what is necessary to support a firm's performance of audit engagements, with less attention being given to expectations or requirements for other types of engagements.</p>	<p>The broader approach of a QMA would enable a firm to consider its quality objectives and the related risks, not only in the context of audit engagements, but also for other types of engagements (e.g., reviews and other assurance engagements, compilations, and agreed-upon procedures).</p>

²⁵ www.iaasb.org/publications-resources/staff-questions-answers-applying-isqc-1-proportionately-nature-and-size-firm

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Interaction of a QMA with the Firm's Culture and Strategy
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- 60** A firm's culture, like other aspects of the environment in which the firm operates, influences the engagement partner and the rest of the engagement team. Environment and culture can affect their mindset, their values, ethics and attitudes, and consequently the way they discharge their responsibilities. While the audit is designed to protect the public interest, firms are commercial entities. Each firm's culture is an important factor in determining how its partners and staff are successful in serving the public interest as they perform audits and at the same time achieve the firm's commercial goals. A QMA would make it clear that firm leadership, as part of the firm's governance structure, is responsible for establishing the firm's overall culture and strategy, and thereby accountable for quality overall.
- 61** A QMA may help to more effectively integrate the firm's quality management system into other aspects of its management structures and business processes. We believe that this would further enhance a firm-wide culture of quality, and leadership accountability for quality. Integration of the firm's quality management system with corporate governance and risk management systems may lead to more proactive processes for understanding and responding to internal and external inspection findings.
- 62** As described in the AQ Framework, a firm's culture and strategy are at the core of a QMA, and foundational to its effectiveness. The firm's overall strategy would be required to incorporate its quality objectives, which, consistent with ISQC 1, would be to establish and maintain a quality management system that provides the firm with reasonable assurance that:
- (a) The firm and its personnel comply with professional standards and applicable legal and regulatory requirements; and
 - (b) Reports issued by the firm or engagement partners are appropriate in the circumstances.²⁶
- 63** Effective operation of the quality management system, including embedding quality in all of the firm's activities, requires a transparent and clear definition, and communication, of roles and responsibilities, as well as sufficient and appropriate resources in terms of human capital, policies, methodologies, tools and other guidance.

Elements of a QMA

- 64** Revising ISQC 1 to incorporate the use of a QMA may include using an approach that is similar to, or aligned with, principles in existing risk management and governance frameworks.²⁷ Key aspects of our preliminary thinking about how ISQC 1 could incorporate a QMA include:
- (a) The relevant activities in support of the continually evolving process of a QMA, the elements of which are set out in the following diagram.
 - (b) Retaining the existing objectives and robustness of requirements in ISQC 1, although the way that the standard is structured would likely be revisited.



²⁶ These quality objectives align with the objectives of ISQC 1, as described in paragraph 11 of the standard.

²⁷ For example, the OECD's *Principles of Corporate Governance*; and *The Enterprise Risk Management™ Integrated Framework* (2004) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO ERM Framework). The COSO ERM Framework is in the process of being updated to make it more relevant in the increasingly complex business environment. COSO expects to publish an exposure draft for public comment in the first quarter of 2016.

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Table 3. Relevant Activities in Support of Elements of a QMA

Elements of a QMA	Relevant Activities
Establish quality objectives	The firm's quality objectives would be an integral part of its overall strategic objectives, set in the context of its business model and culture and would consider the quality implications for each business area. Paragraph 65 describes factors a firm would consider in establishing relevant and appropriate quality objectives. Firm leadership would be directly responsible, with appropriate personnel within firm leadership accountable, for quality.
Perform quality risk assessment	A structured approach to identifying those events and conditions that may have a significant effect on the firm's ability to achieve its quality objectives, including the effect of the interactions with and the role of others in contributing to audit quality as described in the AQ Framework, is foundational to an effective QMA. Identified quality risks are assessed for probability of occurrence and likelihood and magnitude of potential consequences at the firm and by engagement type. This risk assessment process should be sufficiently detailed to serve as a basis for designing and responding to quality risks and implementing quality control activities (see paragraph 66).
Design and implement responses to quality risks	The firm designs appropriate responses to identified quality risks to provide reasonable assurance that the policies and procedures address the risk of the firm not being able to achieve its quality objectives. Some risks may be considered together, while other risks may require more than one response or layered responses. The quality objectives serve as a framework for these decisions, which may result in the development and implementation of policies and procedures. In an audit context, these policies and procedures would help firms increase the prospect of delivering a quality audit.
Implement quality control activities	The firm implements quality control responses and activities through the development of appropriate policies and procedures.
Inform, communicate and document	Identification, capture, and communication of relevant risk information in a format and time frame that enables individuals to carry out their responsibilities is an essential component of a QMA. Communication includes having appropriate communication resources (e.g., information systems infrastructure) to provide timely and relevant information to the firm's leadership regarding the operation of the firm's quality management system, as well as to communicate information about quality across the firm.
Monitor quality	The design and operating effectiveness of the quality management system and related activities are monitored through both integrated and distinct monitoring activities, promoting the consideration by firm leadership of all feedback received on quality. These monitoring activities include external inspections and other reviews (such as peer reviews, internal inspections, pre-issuance and post-issuance reviews—see paragraph 148). The findings from these monitoring activities are considered by firm leadership and used to assess the effectiveness of the firm's quality management system as well as to determine whether remedial action is necessary. Monitoring activities might result in the identification of different risks or reassessment of previously identified risks, and could potentially signal a need for new or improved responses to address such risks or the need to revisit the quality objectives – thereby continually improving the effectiveness of the quality management system.

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In defining and setting its quality objectives under a QMA, the firm could be required to consider various factors, which might include:

- The types of services the firm provides or anticipates it will provide and the types of entities to which they are, or are anticipated to be, provided. The firm may, for example, consider whether:
 - The firm performs (or intends to perform in the future) audits, reviews and compilations and other related services, or only one or a combination of these.
 - The firm performs (or intends to perform in the future) such services for listed entities, other entities of particular public interest and non-listed entities (including small and medium-sized entities), or only one or a combination of these. Are those services performed for entities in particular industries or jurisdictions?
- Its relevant stakeholders (such as users, preparers, audit committees), the interactions of these stakeholders as described in the AQ Framework in contributing to audit quality, and what they expect in seeking to rely on reports issued by the firm.

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66 The identification of risks that may affect the firm's ability to meet its quality objectives is also performed in the context of both types of entities for which engagements are undertaken and the types of those engagements. These include external risk factors (such as the Contextual Factors noted in the AQ Framework) and internal risk factors, such as:

- Assessing qualifications, experience, skills and knowledge of the firm's work force;
- The impact of the organization of the firm, including when the firm uses ADMs to support its engagements;
- The potential effect of staff turnover (i.e., reliance on certain staff and risk that if these staff left the firm, quality would be impacted); and
- Resource availability to staff engagements, including cooperation and sharing of resources within the firm, and prioritization of work when certain individuals perform services for audits as well as other engagements.

Your Feedback

67 We welcome your views about the elements of a QMA and the relevant activities that have been described in paragraphs 50–66. We believe that revising ISQC 1 to incorporate a QMA:

- Would be responsive to stakeholders' concerns;
- Will require greater accountability for quality by firm leadership;
- Could be effectively implemented by firms of all sizes; and
- Over time, would result in improved quality.

The *Quality Control at the Engagement Level* and *The Firm's Role in Supporting Audit Quality* sections of this ITC describe in more detail specific areas for improvement in ISA 220 and ISQC 1, respectively. Regardless of whether we revise ISQC 1 to incorporate a QMA, we are committed to addressing the areas identified for improvement.

QUESTIONS

QMA QC1

CROSSOVER ISSUES / ISSUES RELEVANT TO MORE THAN ONE PROJECT

68 In addition to the discussion on professional skepticism in paragraphs 15–44, the following section sets out the issues that cross-over, or may be relevant to, more than one project covered by this consultation. These issues, and possible actions, are described together to obtain a broader view about why actions that supplement each other in the separate projects are needed, for example, changes made in relation to aspects of ISQC 1 and ISA 220 may have implications for the changes that are being made in ISA 600.

Quality Control at the Engagement Level

Engagement Partner Roles and Responsibilities

ISA 220 sets out the responsibility of the engagement partner for:

- The direction, supervision and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements;
- Reviews being performed in accordance with the firm's policies and procedures;
- Being satisfied through a review of the audit documentation and discussion with the engagement team that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued; and
- The auditor's report being appropriate in the circumstances.

Paragraphs 15–17 of ISA 220

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- 69** As audits continue to evolve and adapt in a changing environment, the fundamental principles and expectations related to the roles and responsibilities of the engagement partner (or group engagement partner as applicable) must, in the public interest, be sufficiently clear, specific and well-articulated within the ISAs.
- 70** The engagement partner²⁸ responsible for each individual audit engagement²⁹ plays an essential role relative to audit quality and users' confidence, given that such partner is the individual responsible for the overall quality of the audit engagement to which that partner is assigned. Clarity about the role and responsibilities of the engagement partner is therefore fundamental to the ongoing effective implementation of the principles-based ISAs and ISQC 1.
- 71** Before an engagement is accepted, or a decision made to continue an engagement, the engagement partner is required to be satisfied that appropriate procedures regarding the acceptance and continuation of client relationships and audit engagements have been followed and that related conclusions reached are appropriate.³⁰ The engagement partner needs to be satisfied that:
- (a) The preconditions for an audit, as set out in paragraph 6 of ISA 210, have been met, including that management has acknowledged its responsibility to provide the auditor with access to the information needed for the performance of the audit and unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
 - (b) The engagement team collectively has the necessary competence and capabilities to properly perform the audit engagement,³¹ and if not, that an appropriate auditor's expert will be used.³²
- 72** ISA 600 builds on the requirements of ISA 220, as well as other ISAs as relevant. Therefore these same requirements are relevant when the audit is an audit of group financial statements. Paragraph 4 of ISA 600 notes that, in accordance with ISA 220, the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities. It notes that the group engagement partner is responsible for the direction, supervision and performance of the engagement. Paragraph 5 of ISA 600 notes that the engagement partner applies the requirements of ISA 220 regardless of whether the group engagement team or a component auditor performs work on the financial information of a component. It adds that ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial statements of components.
- 73** ISA 220 notes that the engagement partner is entitled to rely on the firm's system of quality control.³³ Accordingly, any changes to ISQC 1 to incorporate a more proactive approach to quality management at the firm level (as described in paragraphs 45–67) may better support the engagement partner in making risk-based decisions at the engagement level. For example, the decision to accept or continue an engagement could be better considered in the context of the firm's assessment of quality risks related to the client and the engagement, and considerations around, for example, competence and capabilities of the members of the engagement team might be made in a more structured and informed manner.

²⁸ The engagement partner is defined as "the partner or person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body".

²⁹ As it relates to the public sector environment, the terms "client," "engagement," "engagement partner," and "firm" should, where relevant, be read as referring to their public sector equivalents as defined in International Standard of Supreme Audit Institutions (ISSAI) 40, *Quality Control for Supreme Audit Institutions*, Section 7.

³⁰ ISA 220, paragraph 12

³¹ ISA 220, paragraph 14

³² ISA 620, *Using the Work of an Auditor's Expert*, sets out the requirements and application material for using an auditor's expert.

³³ ISA 220, paragraph 4

Issues

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- 74** Questions and concerns from regulators and audit oversight bodies, and practical challenges identified by practitioners, have arisen about how engagement partners, in certain situations, are meeting their overall responsibility for the performance of audits and demonstrating appropriate direction and supervision throughout.
- 75** Understanding what appropriate direction and supervision of an engagement involves and how to take responsibility for its performance and for appropriate reviews (and therefore what is necessary to achieve compliance with the requirements of ISA 220) depends on the circumstances, including the size and complexity of the engagement. In some situations it can be particularly challenging when determining when and how the engagement partner should be involved and the specific aspects of that involvement, including having sufficient time and appropriate resources available.
- 76** Feedback from stakeholders and our discussions have identified some types or characteristics of engagements where the engagement partner may face challenges in demonstrating appropriate direction and supervision and taking responsibility for the performance of the engagement and for appropriate reviews, including:
- An audit that involves delivery models that are different to the traditional engagement team structures (see further discussion about ADMs in paragraphs 117–123).
 - When other auditors are involved in an engagement that is not a group audit (i.e., the audit is not one of group financial statements and the other auditors are not component auditors as defined by ISA 600). Paragraph 2 of ISA 600 refers to the ability to adapt ISA 600 to these situations, but a lack of more specific requirements or guidance proves challenging in practice (see further discussion on involvement of other auditors in paragraphs 96 and 100).
 - An audit in which the engagement partner is not located where the majority of the audit work is performed, and other auditors are involved in the audit (regardless of whether the audit is a group audit and whether these other auditors meet the definition of component auditors).³⁴
 - Specific to group audits, where group structures include non-controlled entities or SSCs, or where there are issues in obtaining the necessary access to components (either management of the component or the financial information of the components) (access issues and possible actions to address these are further discussed in paragraphs 204–217, SSC issues and possible actions to address them are discussed in paragraphs 194, 244(d) and 269).
- 77** We have already recognized that challenges arise in circumstances where the engagement partner is not located where the majority of the audit work is performed, and other auditors are involved in the audit. As noted in the August 2015 Staff Audit Practice Alert, *Responsibilities of the Engagement Partner in Circumstances When the Engagement Partner Is Not Located Where the Majority of the Audit Work is Performed*,³⁵ these issues arise in part because the nature of these and other multi-location audits make it more challenging for the engagement partner to discharge the required responsibilities for direction, supervision and review of the audit. It may also not be clear as to whether and how ISA 600³⁶ applies in some circumstances, i.e., in addition to the requirements of ISA 220 and other ISAs.

Clarity about the role and responsibilities of the engagement partner is fundamental to the ongoing effective implementation of the principles-based ISAs and ISQC 1.

³⁴ Situations where the engagement partner is not located where the majority of the audit work is performed are referred to by some as audits of “letterbox companies.” The 2015–2016 Work Plan, specifically in relation to planned work on group audits includes issues and concerns about matters related to these kinds of audits. However, these issues and concerns are not unique to group audits and are therefore explored in this quality control section of the consultation.

³⁵ www.iaasb.org/publications-resources/staff-audit-practice-alert

³⁶ ISA 600, paragraph 2

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Other specific issues raised related to appropriate direction, supervision and review of the audit engagement by the engagement partner include:

- That ISA 220 does not explicitly:
 - Address the need for the engagement partner to be satisfied that sufficient time and resources are available to the engagement team such that it will be possible to perform the necessary work to obtain sufficient appropriate audit evidence before the reporting deadline.
 - Include discussion on how the requirement to take responsibility for the direction of the audit engagement is to be applied or what constitutes “active involvement” in an engagement. Although not part of the ISAs, the AQ Framework identifies, as a key attribute to audit quality, the active involvement of the engagement partner in risk assessment, planning, supervision and review of the work performed.
- That ISA 220 is primarily focused on matters related to the planning of an audit engagement. Notwithstanding that ISA 220 provides some guidance on what direction of the engagement team involves,³⁷ there is not much detailed attention to responsibilities of the engagement partner as the audit progresses and is completed.
- Concerns with the consistent application of acceptance and continuance requirements in ISQC 1³⁸ and ISA 220,³⁹ particularly related to the extent of consideration of the relevant ethical requirements for auditors that exist in the jurisdiction(s) in which the entity is located and whether the engagement partner has considered all relevant information prior to accepting or deciding to continue with the engagement.
- That the responsibilities of the engagement partner are located throughout the ISAs. The majority of the responsibilities specific to the engagement partner are incorporated in ISA 220 (with the definition of engagement partner being included in ISQC 1 together with the firm’s responsibilities for establishing policies and procedures to deal with the process of identifying and assigning appropriate engagement partners to audit engagements.) However, many other ISAs, including ISA 230; ISA 240;⁴⁰ ISA 300⁴¹ and ISA 315 (Revised), include requirements for the engagement partner. For audits of group financial statements, ISA 600 addresses responsibilities of the group engagement partner.⁴² However, presenting the requirements for the engagement partner’s responsibilities throughout the ISAs may make the practical application of the requirements more difficult, and challenging for engagement partners to determine if they personally have fulfilled all required responsibilities.

Challenges arise in circumstances where the engagement partner is not located where the majority of the audit work is performed.

79

The ISAs do not explicitly set out who is required to sign the auditor’s report, but require that the engagement partner is responsible for the auditor’s report that is issued on behalf of the firm. In many jurisdictions, the engagement partner is either named in the auditor’s report, or signs the report in his or her own name.⁴³ In some cases and pursuant to law, regulation or custom within a jurisdiction, in addition to or instead of the engagement partner, other partners are named in or sign the auditor’s report. We have heard mixed views about whether the ISAs should address such circumstances (i.e., whether the ISAs should contain appropriate requirements dealing with the responsibilities of an individual being named in or signing the auditor’s report when such individual is not also the engagement partner).⁴⁴

³⁷ ISA 220, paragraph A13

³⁸ ISQC 1, paragraphs 26–28

³⁹ ISA 220, paragraphs 12–13

⁴⁰ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*

⁴¹ ISA 300, *Planning an Audit of Financial Statements*

⁴² ISA 600 sets out with more specificity than the other ISAs the responsibilities of the group engagement partner in relation to the group audit engagement. ISA 600 also clearly differentiates requirements that are the responsibility of the group engagement partner and which are the responsibility of the group engagement team.

⁴³ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, requires that the name of the engagement partner be included in the auditor’s report on a complete set of financial statements for a listed entity.

⁴⁴ The issues addressed in this paragraph do not include situations where firms provide for the ability of a partner within the same firm as the engagement partner to authorize, on behalf of that engagement partner, the signing of the auditor’s report in the name of the firm or the engagement partner or both, subject to adherence to firm policies and procedures that address such situations. For example, such circumstances may arise when the engagement partner is satisfied that the audit has been properly completed and that an appropriate auditor’s report has been drafted, but the partner is temporarily unavailable when the auditor’s report needs to be formally released or issued.

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- 80** In defining the engagement partner, ISQC 1⁴⁵ and ISA 220⁴⁵ establish the overall responsibility of the engagement partner for the performance of the audit engagement and the issuance of the resulting auditor's report on that engagement. ISQC 1 also addresses the responsibility of a firm to assign responsibility for an audit engagement to an engagement partner,⁴⁷ including the need to establish policies and procedures requiring that the engagement partner has the appropriate competence, capabilities and authority to perform the role.
- 81** ISA 220 includes requirements that address the need for the engagement partner to take responsibility for the direction, supervision and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements;⁴⁸ reviews being performed in accordance with the firm's policies and procedures;⁴⁹ being satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report;⁵⁰ and for the auditor's report being appropriate in the circumstances.⁵¹
- 82** To facilitate compliance with these requirements, ISA 220 provides guidance, including setting forth in paragraph A13 what direction of the engagement team may involve, and guidance in the area of supervision in paragraph A15. Paragraphs A16–A19 address performance of reviews and paragraph A20 addresses situations where a member of the engagement team has expertise in a specialized area of accounting or auditing.
- 83** ISQC 1⁵² and ISA 220⁵³ include requirements and related application material that address the firm's and engagement partner's responsibilities, respectively, relating to policies and procedures for the acceptance and continuance of client relationships and specific engagements. Specifically:
- (a) ISQC 1 includes application material to the requirements relating to accepting or continuing an engagement that highlight consideration of whether the firm is able to complete the engagement within the reporting deadline as being relevant to the determination as to whether or not the audit firm has the appropriate resources to accept an engagement.⁵⁴ This concept is not currently addressed in ISA 220; and
 - (b) ISQC 1 requires the firm to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm can comply with relevant ethical requirements.⁵⁵ ISQC 1 requires the firm to establish policies and procedures to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including independence requirements.⁵⁶ ISA 220 requires the engagement partner to remain alert for non-compliance with relevant ethical requirements by members of the engagement team, and to determine (in consultation with others in the firm) the appropriate action when non-compliance is identified.⁵⁷

The active involvement of the engagement partner in risk assessment, planning, supervision and review of the work performed is a key attribute of audit quality.

⁴⁵ ISQC 1, paragraph 12(c)

⁴⁶ ISA 220, paragraph 7(a)

⁴⁷ ISQC 1, paragraph 30

⁴⁸ ISA 220, paragraph 15(a)

⁴⁹ ISA 220, paragraph 16

⁵⁰ ISA 220, paragraph 17

⁵¹ ISA 220, paragraph 15(b)

⁵² ISQC 1, paragraphs 26–28

⁵³ ISA 220, paragraphs 12–13

⁵⁴ ISQC 1, paragraph A18

⁵⁵ ISQC 1, paragraph 26(b)

⁵⁶ ISQC 1, paragraphs 20–25 and A7–A17

⁵⁷ ISA 220, paragraphs 9–10 and A4–A5

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84 In addition to indicating that the group engagement partner is responsible for the direction, supervision and performance of the group engagement and for whether the auditor's report is appropriate in the circumstances,⁵⁸ ISA 600 sets out specific responsibilities for the group engagement partner, including in respect of:

- (a) Acceptance and continuance and agreeing the terms of engagement.⁵⁹
- (b) Determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of components, and whether the group engagement team will be able to be sufficiently involved in any work performed by component auditors.⁶⁰
- (c) Reviewing the overall audit strategy and audit plan.⁶¹
- (d) Evaluating the effect on the group audit opinion of any uncorrected misstatements and any situation where there has been an inability to obtain sufficient appropriate audit evidence.⁶²

Possible Actions to Address the Issues

85 In discussing the responses to address the issues, we identified the following possible actions:

- Providing further clarity in ISA 220 about what is meant by performance, direction, supervision and review by the engagement partner, either by strengthening the requirements or enhancing the application material that discusses the responsibilities of the engagement partner in relation to these matters. For example, this may include adding more specificity as to the engagement partner's responsibilities, such as:
 - Providing more direction and specificity as to what audit documentation is required to be reviewed by the engagement partner and the nature of the related review procedures.
 - Placing more emphasis on the need for considering whether there are adequate resources for the engagement, including the suitability of the engagement team members' skills, competence and experience, the need for auditor's experts and the sufficiency of time available to perform the engagement before the reporting deadline.
 - Inclusion of examples that illustrate what the engagement partner can do to demonstrate proactive and appropriate direction, supervision and review in various situations that have been highlighted as not being specifically addressed in the ISAs or not addressed in sufficient detail, for example, where there are access issues, when other auditors are involved in the audit engagement or where ADMs are used.
- Adding and building on the concepts in the AQ Framework⁶³ relating to active involvement of the engagement partner in the risk assessment, planning, supervision and review of the work performed, to the extent feasible, either as requirements or application material.
- Building into ISA 220 (and ISA 600) a more proactive, scalable and robust approach to the identification of risks to audit quality at the engagement level, and development of specific responses to address those risks.
- Strengthening the requirements or enhancing the application material that discuss the responsibilities of the firm and the engagement partner in relation to decisions regarding acceptance and continuance of client relationships and specific engagements. This could be done, for example, by building on the concepts in the AQ Framework related to values, ethics and attitudes in relation to engagement acceptance and continuance decisions.
- Clarifying that, as part of their responsibilities, engagement partners should be appropriately involved at all stages of the audit (i.e., planning, performance and completion).

⁵⁸ ISA 600, paragraph 11

⁵⁹ ISA 600, paragraphs 12–14

⁶⁰ ISA 600, paragraph 12

⁶¹ ISA 600, paragraph 16

⁶² ISA 600, paragraph 45

⁶³ Paragraph 68 of the AQ Framework sets out the key attributes for the engagement partner at the engagement level, including that the engagement partner is actively involved in risk assessment, planning, supervising, and reviewing the work performed.

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- Adding an appendix to ISA 220 that indicates where the responsibilities of the engagement partner are articulated within the requirements and application material in the ISAs (with a similar appendix to ISA 600 to deal with the responsibilities of a group engagement partner).
- Consider the need to develop requirements or application material to specifically address situations where an engagement partner is not located where the majority of the audit work is performed. This may include providing more clarity as to the responsibilities of the engagement partner in these situations and expanded guidance as to how the responsibilities for direction, supervision, review and for the performance of the audit engagement are expected to be addressed, such that the engagement partner can be in a position to take responsibility for the overall quality of the engagement and the auditor's report.

86 Recognizing that there are mixed views about the issue, it has been suggested that the situations relating to the signing of the auditor's report set out in paragraph 79 could be more specifically acknowledged in the ISAs. Consideration could also be given to clarifying the expected performance requirements for individuals other than engagement partners who sign or who are named in the auditor's report. For example, such individuals could at a minimum be expected to perform the same procedures that an EQC reviewer would perform. On the other hand, it has also been observed that there are generally local laws, regulations or customs that govern such practices and that requirements and guidance are therefore better established by local regulators or NSS. It has also been observed that additional focus on this area in the ISAs could confuse stakeholders and detract from the fundamental role played by and responsibilities of the engagement partner.

QUESTIONS

Engagement Partner Roles and Responsibilities QC2

Others Involved in the Audit

- 87 In addition to the engagement team (including the engagement partner), one or more of the following could be involved in the audit or contribute to its quality:
- Engagement Quality Control Reviewer**—see paragraphs 136–146.
 - Component Auditors**—discussed further in the group audits section in paragraphs 235–242.
 - Other Auditors**⁶⁴—see paragraphs 96 and 100.
 - Auditor's Experts**⁶⁵—see paragraph 95.
- 88 Although the engagement partner takes overall responsibility for an audit engagement, there are other participants in an audit engagement who influence and contribute to the overall quality of the engagement and support the engagement partner in planning and performing it. It is the engagement partner's responsibility to be satisfied that the engagement team, and any auditor's experts that are not part of the engagement team,⁶⁶ collectively have the appropriate competence and capabilities to perform the audit engagement.⁶⁷
- 89 In relation to the engagement team, the AQ Framework notes a key attribute influencing audit quality is that the staff members performing detailed "on-site" audit work have sufficient experience, their work is appropriately directed, supervised and reviewed, and there is a reasonable degree of staff continuity. The engagement partner has a critical role to play in encouraging the engagement team to embrace and exhibit the values, ethics and attitudes necessary to support a quality audit.

⁶⁴ For purposes of this discussion, other auditors includes service auditors.

⁶⁵ This ITC includes discussion about our priority projects on professional skepticism, quality control and group audits. The reference to auditor's experts is presented for completeness, but issues and concerns related to using an auditor's expert are only very briefly discussed in this ITC.

⁶⁶ The term engagement team is defined to exclude any auditor's experts that are engaged by the firm or a network firm, i.e., auditor's internal experts (those that are employed by the firm or a network firm) would be considered members of the engagement team.

⁶⁷ ISA 220, paragraph 14

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- 90** As corporate and audit firm structures continue to evolve in the increasingly global environment, and become more complex, the composition of the engagement team, and others participating in the audit and where they are located, is changing, and may now increasingly include:
- (a) Members of the engagement team with expertise in specialized areas of accounting or auditing (e.g., individuals with specific expertise in particular accounting standards or industry-specific expertise).
 - (b) Component auditors (see paragraphs 235–242) and other auditors (see paragraphs 96 and 100).
 - (c) A variety of different auditor's experts (e.g., valuation experts, environmental experts, actuarial experts).
 - (d) Engagement team members situated at different locations or as part of an ADM and sometimes located in another jurisdiction (ADM's are discussed further in paragraphs 117–123).
- 91** Group audits are addressed by ISA 600. ISA 600 assists the group engagement partner in meeting the requirements of ISA 220 where component auditors perform work on financial information of components. ISA 600 also acknowledges that a component auditor may express a separate opinion on the financial information of a component⁶⁸ and issue a standalone report, but the standard precludes the group engagement team from making reference in the auditor's report on the group financial statements to such a report of the component auditor (unless making such reference is required by law or regulation)⁶⁹ (see paragraphs 98 and 102).
- 92** In some cases, audits may involve other auditors who are not component auditors (i.e., other auditors that do not meet the definition of component auditors).⁷⁰ Their involvement may be a function of how an entity is structured, or the circumstances of a particular audit, for example, the audited entity may be using a SSC for transactional processing and the audit work related to the SSC may be performed by another engagement team.
- 93** Various issues and challenges relating to the involvement of others during the audit have been identified, and where not covered elsewhere in this ITC, are discussed below.

Issues

- 94** Concerns have been expressed by regulators and audit oversight bodies about situations where direction and supervision of the members of the engagement team does not appear adequate and the reviews of their work do not appear to have been performed properly. Similarly, concerns have been raised regarding the direction, supervision and review of the work of other auditors involved in the audit (including in the case of group audit engagements, component auditors; however these issues are considered further in the section on group audits of this ITC).
- 95** In particular, questions pertaining to the competence and capabilities of the engagement partner and engagement team have arisen in certain circumstances, such as audits of financial institutions, or others in which fair value measurements are prevalent. In such circumstances, the consideration of the need to involve team members with specialized skills or knowledge or an auditor's internal or external expert, or to undertake consultations within the firm, likely become more important to achieve a quality audit. Some firms are operating in a manner that brings the necessary expertise "in-house" to support complex engagements, such as audits of financial institutions. However, this approach may not be feasible for

⁶⁸ ISA 600, paragraph 3

⁶⁹ ISA 600, paragraph 4

⁷⁰ In situations where the entity uses a service organization, other auditors may be involved. ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*, addresses the relevant audit considerations in these situations, including the ability of the auditor to use the report of the service auditor as audit evidence.

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all firms, including SMPs. Using an “in-house” or internal expert does not relieve the engagement team from its responsibilities to evaluate the adequacy of an auditor’s expert’s work. Concerns have been raised about situations where the auditor’s considerations around using the work of auditor’s experts, such as understanding the expert’s field of expertise and evaluating the adequacy of the expert’s work, are not adequately performed or demonstrated (e.g., through appropriate audit documentation).

- 96 Paragraph 2 of ISA 600 notes that ISA 600 may be adapted as necessary when an audit is not a group audit, but other auditors are involved; however the ISAs do not provide any additional clarity as to the circumstances when this paragraph would be relevant or how ISA 600 can or should be adapted in order to assist the engagement partner in addressing the requirements of ISA 220. Concerns have been raised that the lack of explicit guidance has resulted in inconsistency about how other auditors are addressed in such circumstances, and in particular in situations when the engagement partner is not located where the majority of the audit work is performed.
- 97 As discussed in the group audits section (see paragraphs 235–242), group engagement teams may be faced with situations where it is challenging and in some cases almost impossible to have the necessary level of involvement in the work of component auditors (e.g., in the case of non-controlled components where access to either or both the component and the component auditors may be restricted). In some of these situations, a component auditor may issue a separate report on the financial information of the component. ISA 600 currently provides for the ability to use the audit evidence on which such component auditor opinions are based, but precludes the ability of the group engagement team to make reference in the auditor’s report to such reports. In many cases, the stand-alone reports that are issued by component auditors on component’s financial information are general purpose reports. Making reference to the report of another auditor was the subject of extensive debate when ISA 600 was developed, and it was the clear view of the IAASB at that time that it was not appropriate to allow for such reference to be made (other than where required by law or regulation.) We note, however, that this practice is permitted in certain jurisdictions, including the United States.
- 98 We have also heard questions about whether more transparency about the audit could be provided by permitting or requiring disclosures in the auditor’s report about the role of other auditors in the (group) audit. In exploring changes to the ISAs during the recently completed Auditor Reporting project, we initially explored this question; however in finalizing the revised standards, and based on feedback from respondents to that consultation, we agreed to not pursue this matter any further. However, we still hear that providing users with information that enables them to evaluate the participation of other auditors may increase transparency about the audit and how it was performed.
- 99 Lastly, in many places in the ISAs the requirements focus on the responsibilities of the “auditor.” The use of the term “auditor” may refer to the firm, engagement partner or engagement team, as appropriate in the circumstances, recognizing that the engagement partner may delegate responsibility for tasks to others. This does not detract from the overall responsibility of the engagement partner for the audit and the auditor’s report, but allows tasks to be delegated to the others involved in the audit. However, it may be unclear in certain instances that some relevant tasks should not be delegated, and should remain the responsibility of the engagement partner.

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Possible Actions to Address the Issues **AUASB Meeting 22 February 2016**

- 100** The circumstances of audit engagements vary widely and all such circumstances cannot be anticipated in the ISAs (including situations when the definitions of group audit, component and component auditors as set forth in ISA 600 do not apply to a particular engagement). However, we could consider whether specific requirements and application material are warranted when other auditors (that are not component auditors or not otherwise part of the engagement team) are involved in the audit engagement. In developing possible requirements and guidance, we believe that it would be important to first focus on the core principles established by ISA 220, in particular those core principles in relation to the engagement partner's responsibilities and the necessary direction, supervision and review of the work of the other auditor. We could also give further consideration to incorporating matters such as the assessment of professional competence and capabilities of the other auditors, and evaluation of the sufficiency and appropriateness of the work these auditors have performed.
- 101** As part of our group audits project, we could consider exploring whether to revisit the requirements that currently preclude the ability to make reference to the report of another auditor. Although we realize that this matter has been extensively debated in the past, we have heard a call to revisit the current requirements in light of practical challenges such as those described in paragraph 97. We may therefore explore the ability to use another auditor's report as audit evidence in certain circumstances. Questions about this approach would include when doing so might be appropriate, what the responsibilities of the engagement team should be, and whether it might be necessary to communicate in the auditor's report when this circumstance arises (e.g., whether it might be necessary to make reference in the auditor's report on the group financial statements to the report of the component auditor.) See paragraphs 197–198 in the group audits section and question GA 1 (c).
- 102** In addition to exploring the ability to make reference to the report of another auditor, we intend to further explore whether greater transparency in the auditor's report about the involvement of others in the (group) audit may be beneficial. For example, could the auditor's report say more about the nature and extent of involvement of others in the audit, including component auditors, other auditors and auditor's experts?⁷¹
- 103** As we progress work on our priority projects and in looking at clarifying the requirements in ISQC 1, ISA 220 and ISA 600, we may consider whether certain responsibilities attributed to the "auditor" should be more specifically characterized as responsibilities of the engagement partner or the engagement team.
- 104** We will also consider, as part of our consultations on our future Work Plan, the need for further consideration of issues and concerns relating to the involvement of auditor's experts.

QUESTIONS

Others Involved in the Audit QC3

⁷¹ We note that the PCAOB has, subject to SEC approval, finalized a rule that will require auditors of U.S. issuers (listed entities) to file a form with the PCAOB that describes the involvement of certain participants (including other auditors) in the audit engagement. The information included on the form will be made available on the PCAOB's website. See <http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx> for more information.

The Firm's Role in Supporting Audit Quality

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105 In the current evolving environment, firms are operating in many and varied ways that potentially affect the way that firms and engagement teams are structured and how audits are performed. We believe it is necessary to give further consideration to issues arising in relation to these matters, including:

- (a) Firms that operate through arrangements that share:
 - (i) Common policies and procedures for performing the work (e.g., audit methodologies);
 - (ii) Common quality control policies and procedures; or
 - (iii) Common monitoring policies and procedures.⁷²
- (b) Models with service delivery that are different to traditional engagement team structures. These are sometimes referred to as "audit firm shared service centers," "centers of excellence," "on-shoring," "offshoring," or "outsourcing" (referred to in this ITC as ADMs).

Quality Control Considerations When Operating as Part of a Network

Some audit firms operate internationally through a network of firms. Network firms often share common methodologies and quality control and monitoring policies and procedures. Some networks also share guidance in relation to values, ethics, and attitudes, and have programs to enhance the knowledge and experience of partners and staff.

- Paragraph 107 of Appendix 2 of the AQ Framework

106 ISQC 1 refers to the fact that some firms operate as part of a network of firms. The definition of a network in ISQC 1 contains elements that are broader than the sharing of common quality control policies and procedures and common methodologies. In reality, networks of firms vary significantly and the extent of sharing of and reliance on common quality control policies and procedures and common methodologies can vary considerably. For purposes of this ITC, the term "network of firms" (network) refers only to arrangements where firms share common quality control policies and procedures or common methodologies. The following are often observed in network arrangements:

- Firms within a network are not owned or controlled by the network entity for various reasons, including jurisdictional law and regulation, and risk and litigation management purposes.
- The extent of operational and decision-making power at the network level varies among networks and enforcement powers in relation to individual network member firms may be limited. Compliance at the individual member firm-level with shared common quality control and monitoring policies and procedures and common methodologies can be influenced through economic and other measures, but often cannot be centrally controlled.

107 Currently very few jurisdictions have law or regulation that govern networks and the way they are structured and managed. Where such law or regulation exists, application is generally limited to firms that operate within the jurisdiction. We acknowledge that firms may be organized under many different arrangements, and recognize that our standards cannot mandate or anticipate all the ways in which firms might be structured today or in the future.

108 ISQC 1 and the ISAs do not establish any requirements for firms at the network level nor do they address in any significant detail a firm's ability to place reliance on network policies and procedures to address firm-level or engagement-level responsibilities for quality control.

⁷² Firms that operate through such arrangements are typically referred to as a network or network firms. Our standards define a "network" as "A larger structure that is (a) aimed at cooperation; and (b) is clearly aimed at profit or cost-sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand name, or a significant part of professional resources".

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A firm that operates as part of a network may seek to rely on the network's system of quality control (including monitoring policies and procedures), to address some of the firm's responsibilities established by ISQC 1. In relation to this, concerns have been raised by regulators and audit oversight bodies that there may be undue reliance by firms on the network's system of quality control in some circumstances.

110

More specifically, regulators and audit oversight bodies have:

- Highlighted that ISQC 1 does not extend to, or address, the monitoring procedures that may, or may not be, performed at the network level.
- Expressed concerns that networks are not adequately considering the results of external inspection findings of individual firms within the network, and their implications to the network as a whole, and making appropriate communications about such matters within the network.
- Noted concerns about their ability to access audit documentation of other firms in the network, including the ability of firms within the network to share information with them.

111

At the engagement level, issues have arisen about whether, how and under what circumstances engagement teams can rely on the common systems of quality control when using work performed by other auditors from the same firm or a network firm. Specifically, concern has been raised about a group engagement team placing reliance on the firm or network quality control policies and procedures without due consideration of an appropriate basis for doing so. For example, we have heard concerns about situations when a group engagement team may place reliance without conducting a proper assessment on network-level policies and procedures relating to independence, and competence and capabilities of the component auditor (i.e., because the component auditor is believed to have or be subject to the same quality control policies and procedures as the group engagement team).

Concerns have been raised that firms may be unduly relying on networks' systems of quality control.

*References to Existing Requirements and Application Material***112**

Where firms are within a network that operates under common monitoring policies and procedures, and the firms have implemented monitoring procedures on a network basis that are relied on by the individual firms, ISQC 1 requires firm policies and procedures for communication by the network:

- At least annually, of the overall scope, extent and results of monitoring process to the firms within the network; and
- Of any deficiencies in the system of quality control to the firms in the network so the necessary action can be taken.⁷³

113

ISA 600 sets out application material relating to considerations about how the group engagement team's procedures may be affected by whether the group engagement team and component auditor have common policies and procedures for performing the work, common quality control policies and procedures or common monitoring policies and procedures.⁷⁴ ISA 220 provides for the ability of the engagement team to rely on the firm's system of quality control, unless information provided by the firm or other parties suggest otherwise.⁷⁵ This may include, for example, competence of personnel, independence, maintenance of acceptance and continuance systems, and adherence to applicable legal and regulatory requirements through the monitoring process.⁷⁶

⁷³ ISQC 1, paragraph 54

⁷⁴ ISA 600, paragraphs A33–A34

⁷⁵ ISA 220, paragraph 4

⁷⁶ ISA 220, paragraph A2

Possible Actions to Address the Issues **Agenda Item 8.**
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- 114** Clarity in ISQC 1 and ISA 220 about what should be considered and documented by the individual firm as a basis for the reliance on network policies and procedures at the firm level (including for example, a common audit methodology or audit technology) is important. While recognizing the importance of maintaining principles-based standards, specific actions we could take include:
- (a) Revisiting the existing requirements and application material in ISQC 1 to more explicitly address the considerations about the extent to which firms can rely on network quality control and monitoring policies and procedures in designing policies and procedures to comply with ISQC 1 at the firm level. This could include, for example, more clearly describing what the firm is required to do at the firm level, and the engagement level, to appropriately rely on network firm quality control and monitoring policies and procedures. Such revised requirements would need to address what would be expected if the component auditor did not share common quality control and monitoring policies and procedures. We may need to explore alternatives that have similarities to the “service organization” concept followed by corporate entities that choose to rely on others for certain aspects of their financial reporting obligations and the related reporting by service auditors (i.e., using the principles of ISA 402 and ISAE 3402).⁷⁷
 - (b) Strengthening the requirements and application material in ISQC 1 in relation to inspections that have taken place across the network and related communications, including, for example, providing more specificity about:
 - (i) The impact on the firm, and for an engagement, if applicable, of the outcome of these inspections, addressing circumstances where law or regulation may preclude the sharing of information.
 - (ii) How the firm responds to the inspection findings.
 - (iii) The impact on the firm’s own system of quality control, including monitoring policies and procedures, designed to comply with ISQC 1.
- 115** Paragraph 242(c) sets out possible actions to address issues in a group audit relating to reliance at the engagement level on common systems of quality control and monitoring when using work performed by component auditors from the same firm or a network firm.
- 116** In exploring possible changes to the standards in relation to network firms, we have recognized that network and firm structures may be highly influenced by law or regulation in the various jurisdictions where networks and individual firms are established. Mixed views have been expressed about whether requirements for networks themselves could or should be established. We believe it would likely be very challenging for us to develop requirements for networks because:
- Networks or alliances may be structured differently.
 - The nature and extent of their common policies and procedures will vary
 - Structures may be highly influenced by applicable law or regulation in the various jurisdictions in which networks and individual firms are established.

We would therefore like to understand stakeholder views on this matter to be able to determine a way forward.

⁷⁷ International Standard on Assurance Engagements™ (ISAE™) 3402, *Assurance Reports on Controls at a Service Organization*

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Exploring the Potential Effects that Firms' Changing Business Models and Structures Have on Audit Quality (ADMs)

117 In conducting audits, some firms use ADMs that are different to the traditional engagement team structures. These responses are reactions to changes in the global business environment, technology developments that better facilitate the functioning of virtual engagement teams and, in some cases, to changes in how the entities being audited are organizing themselves. Examples of ADMs include:

- (a) Elements of the firm's system of quality control that are performed in a centralized location (e.g., independence monitoring).
- (b) Certain standard audit procedures for all or many of the firm's audit engagements that are performed by dedicated central resources (e.g., centralized functions to manage external confirmation processes).
- (c) Centralized resources that are available to perform audit procedures at the request of individual engagement teams.

In some cases, these centralized resources may be physically located in a jurisdiction or in a location other than where the majority of the engagement team is located.

118 The manner in which ADMs are structured, how they operate (including where the auditors are located), and the approaches to the oversight of the work performed can vary significantly across firms.

Issues

119 Concerns have been expressed by regulators and audit oversight bodies about quality control in relation to ADMs, in particular about how an engagement team addresses requirements for retaining responsibility for the direction, supervision, performance and review of the work performed at ADMs. Specific areas of concern include:

- How the firm's leadership and oversight is extended to centralized locations or over centralized resources, particularly those that are in remote locations, as part of the firm's system of quality control.
- Whether the firm's established quality control and monitoring policies and procedures to govern the work that is performed at the centralized locations or by other centralized resources is sufficient, and whether appropriate documentation demonstrates how the engagement team assessed the work in relation to the audit being performed.
- The competency of the personnel performing the audit procedures in relation to the complexity, and judgment required, of the audit procedures being performed, including the implications of the remoteness of the personnel from the engagement team it is supporting and the inability to interact with management of the entity in completing specific tasks.
- How personnel performing procedures at these centralized locations or other centralized resources are supervised, including the review of the procedures performed, and whether these are sufficient. For example, it has been suggested that direction and supervision by the engagement team of individuals that are part of ADMs may not be as rigorous as the direction and supervision of other members of the engagement team that they are supporting.
- Whether the procedures performed at these centralized locations or by other centralized resources, including evidence of review, is appropriately documented.

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Firms have informally indicated that, where applicable, their internal methodologies require at least the same policies and procedures in respect of direction, supervision and review of audit procedures performed at the centralized locations or by other centralized resources as that of the engagement team. In some instances, it has been noted that there are incremental quality control procedures in this area. Examples include policies and procedures for:

- Minimum education and experience requirements for personnel at the centralized location or other centralized resources to demonstrate competence;
- Obtaining confirmation by personnel at the centralized location or other centralized resources that they meet those educational and experience requirements;
- Defining the work to be performed by the personnel at the centralized locations or other centralized resources to pre-determined specific procedures (with consideration given as to the extent of complexity and professional judgment needed to perform those audit procedures);
- Providing detailed instructions as to the performance of those procedures; and
- Direction, supervision and review taking into consideration the experience of the people undertaking the work, and the nature of the work being performed.

References to Existing Requirements and Application Material

121

Neither ISQC 1 nor the ISAs contain explicit requirements or application material related to ADMs. However, it is understood that firms are applying ISQC 1 and ISA 220 in situations involving ADMs and continue to develop their own internal methodologies in respect of the types of work that may be performed at centralized locations or by other centralized resources, as well as guidelines as to how that work should be performed.⁷⁸

Our standards could better acknowledge the use of new audit delivery models.

Possible Actions to Address the Issues

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We believe it would be useful to explore how ISQC 1 and the ISAs could acknowledge the use of ADMs, and emphasize the need for appropriate policies and procedures for these structures as part of the firm's system of quality control and at the engagement level. For example, the ISAs might better emphasize the importance of considering how responsibilities for direction, supervision, performance and review are best achieved when ADMs are involved, specifically in instances where centralized locations or centralized resources are utilized in conducting the audit. We recognize the evolving nature of these arrangements and, in making changes for ADMs, will consider the need to maintain the flexibility of the standards as the nature and extent of use of ADMs continues to change. It may, however, be helpful to clarify.

- (a) That the engagement partner retains responsibility for the direction, supervision, performance and review of the work performed, regardless of who performs the work and where it is performed.
- (b) How these centralized locations or other centralized resources are viewed in the context of the definition of engagement team set out in the ISAs. In this regard, it may be necessary to address how policies and procedures relating to the level of direction, supervision and review need to be tailored to take account of differences in matters such as language, culture, background, or levels of experience of individuals in the ADM.
- (c) That firms' systems of quality control need to take into account the implications of using ADMs, and the need for appropriate quality control policies and procedures to safeguard against inappropriate use of ADMs or ineffective oversight of work performed by auditors in an ADM.

⁷⁸ Similar to circumstances discussed in our Staff Audit Practice Alert, *Responsibilities of the Engagement Partner in Circumstances when the Engagement Partner is Not Located where the Majority of the Audit Work is Performed*, ISQC 1 and ISA 220 apply in these circumstances.

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In this regard we have considered a number of possible actions, including strengthening ISQC 1 and ISA 220 to provide additional requirements or application material, or clarifications of existing requirements and application material, to more explicitly address direction, supervision and review of procedures performed at a centralized location or by other centralized resources. These could include strengthening the auditor's consideration of:

- The risk of material misstatement associated with the account or balance on which the audit procedure is being performed, such that appropriate safeguards are put into place to assess:
 - The level of complexity of the audit procedure; and
 - The level of judgment required to perform the audit procedure,

in relation to the competencies and experience of the personnel at the centralized location or other centralized resources tasked with performing the audit procedure.

- Whether the audit procedure is capable of being performed at a location that is remote from the engagement team and the entity being audited and, in particular, not require face-to-face interaction with management to be properly performed.
- Whether performance of the audit procedure is capable of being directed and supervised remotely.
- Whether communications with management or those charged with governance about the planned use of personnel at a centralized location or other centralized resources is necessary.
- The nature and extent of documentation required by those performing an audit procedure at a centralized location or by other centralized resources, and those directing, supervising and reviewing the performance of the audit procedure.
- Whether the performance of audit procedures at a remote location would result in a breach of client confidentiality, or any legal or cross-border restrictions.
- Whether policies and procedures to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of engagement documentation are appropriately designed in the context of procedures performed at a centralized location or by other centralized resources.

We note however that circumstances vary widely and challenges may arise because of restrictions imposed by local law or regulation, such as where regulators face challenges in obtaining access to the working papers prepared in other jurisdictions. Changes to the standards are not going to solve issues in all circumstances or in all jurisdictions.

QUESTIONS

The Firms' Role in Supporting Audit Quality QC4

QUALITY CONTROL SPECIFIC MATTERS

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In addition to those matters discussed in relation to a QMA and in the previous section relating to crossover issues / those issues relevant to more than one project, the following section focuses on other matters relevant to the revision of ISQC 1⁷⁹ and ISA 220.

⁷⁹ ISQC 1 also applies more broadly to firms that conduct engagements other than audits of historical financial statements (including compilation engagements, agreed-upon procedures engagements, review engagements and other assurance engagements). This ITC focuses on ISQC 1 as it applies to audits of historical financial statements. In considering changes to the standard and how it is structured, consideration will however also be given to clarifying how ISQC 1 applies to these other types of engagements.

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- 125** Firm leadership has a vital role in promoting a culture that emphasizes the importance of the role of the audit in the public interest and therefore the importance of audit quality. Firm leaders are responsible for establishing policies and procedures to achieve quality-related objectives, monitoring compliance with such policies and procedures and instilling a culture of accountability for quality throughout the firm in the context of all the services it provides. Governance of a firm includes leadership responsibility for quality, oversight by firm leadership over the implementation of responses to risks of the firm not meeting its quality objectives and the oversight of firm leadership itself.
- 126** Since ISQC 1 was issued, there have been developments by a variety of policymakers and others that emphasize the principles of good governance. These include, for example, development of governance codes and quality frameworks that apply specifically to firms⁸⁰ and refinement of governance codes that are intended for corporate organizations.⁸¹
- 127** Our view is that effective firm governance and leadership should include structures and mechanisms for:
- Oversight of a firm's leadership that appropriately reflect the firm's circumstances;
 - Direct responsibility of firm leadership, and accountability of appropriate personnel within firm leadership, for quality;
 - Establishing policies and procedures to provide for appropriate supervision, control and monitoring of quality within the firm;
 - The allocation of responsibilities, at the firm and engagement level;
 - Generating a culture of openness that encourages collaboration and consultation; and
 - Resolving conflicts of interest that may arise in relation to the performance of audit services versus other firm services (e.g., allocation of firm resources).
- 128** Lastly, concerns have been brought to the attention of the IESBA in relation to the lack of identification of appropriate personnel within firm leadership to be responsible and accountable for independence matters.

We may be able to more explicitly address the concepts of governance of the firm, including leadership responsibilities for quality, in ISQC 1.

Issues

- 129** ISQC 1 does not address firm governance. The standard does not provide much detail or guidance as to what is expected from firm leadership, nor does it include well-understood and commonly used terminology such as "tone at the top" and "leading by example." In addition, it does not include guidance related to the important role that firm leaders play in sustaining and continually improving audit quality through effective leadership at the firm level, or that addresses the concept of accountability of firm leadership. These matters have been identified by regulators and audit oversight bodies as possible missing components within ISQC 1. Although accountability and responsibility are often used interchangeably, responsibility is slightly different than accountability. Responsibility refers to being in charge of, or owning, the task, whereas accountability refers to answering with regard to the outcome of the task.

⁸⁰ For example, *The Audit Firm Governance Code* (Institute of Chartered Accountants in England and Wales and UK Financial Reporting Committee); *Oversight and transparency, A code for audit firms holding a Public Interest Entity (PIE) licence* (Nederlandse Beroepsorganisatie van Accountants); European Commission Directive 2006/43/EC of the European Parliament and Council of 17 May 2006 and Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014; US Center for Audit Quality (CAQ) *Approach to Audit Quality Indicators*; and ISO 9001 (2015). We acknowledge that there may be other firm specific codes and frameworks that may be relevant and welcome feedback from respondents as to others that should be considered.

⁸¹ For example, the OECDs Principles of Corporate Governance; COSO 2013 Internal Control Framework; COSO Enterprise Risk Management (ERM) Framework; and ISO 9001 (2015). We acknowledge that there may be other corporate governance codes and frameworks that may also be relevant and welcome feedback from respondents as to others that should be considered.

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- 130** ISQC 1 addresses leadership responsibilities for quality within the firm, requiring that the firm establish policies and procedures designed to promote an appropriate internal culture, recognizing that audit quality is essential in performing engagements and requiring that the firm's chief executive officer (or equivalent) or, if appropriate, the firm's managing board of partners (or equivalent) assume ultimate responsibility for the firm's system of quality control.⁸² ISQC 1 requires that those assigned operational responsibility for the firm's system of quality control have the appropriate experience and ability, and the necessary authority to perform those duties.⁸³

Possible Actions to Address the Issues

- 131** We believe it is necessary to evaluate whether and, if so, how firm governance could be best addressed in ISQC 1. Recognizing that firm structures vary, and are affected by law or regulation in the jurisdiction(s) in which the firm operates, we will seek to find opportunities to enhance ISQC 1 to emphasize the importance of governance and a focus on quality at all levels within a firm, including through the use of a QMA.
- 132** For example, leadership responsibilities could be clarified in ISQC 1 through additional requirements or application material, or clarifications of existing requirements and application material, to more explicitly incorporate commonly used and familiar terminology (e.g., "tone at the top" and "leading by example"). Further emphasis could be given in ISQC 1 to the importance of firm leadership setting an appropriate culture for the firm and for taking responsibility and being accountable for extending that culture throughout the firm. This point may be particularly relevant when considering the increasing diversity in how firms organize themselves, the manner in which they are governed, and in how engagement teams are structured.
- 133** In addition to addressing leadership responsibilities for quality within the firm, we are considering whether ISQC 1 should require accountability of firm leadership, or appropriate personnel within firm leadership, for matters related to quality.
- 134** In response to concerns in relation to firms' independence that were brought to the attention of the IESBA, it may be necessary to strengthen ISQC 1 by more specifically requiring a firm to identify appropriate personnel within firm leadership to be responsible and accountable for independence matters.
- 135** In the context of leadership's responsibility for the firm's system of quality control, the concept of the public interest could be explicitly incorporated into ISQC 1. Recognizing that "public interest" can have a different meaning for different stakeholders, establishing a requirement in ISQC 1 for firm leadership to act in the public interest would be challenging to design and implement. Taking into account the due process followed in standard setting, including broad stakeholder involvement, a presumption exists that the public interest is inherently achieved in faithfully applying International Standards. Nevertheless, it may be useful to emphasize in ISQC 1 the importance of relevant public interest considerations in relation to the design of the firm's system of quality control. This emphasis could be incorporated into the introduction to ISQC 1 or into the application material associated with requirements relating to leadership responsibilities.

QUESTIONS

Governance of the Firm, Including Leadership Responsibilities for Quality QC5

⁸² ISQC 1, paragraphs 18 and A4–A5

⁸³ ISQC 1, paragraphs 19 and A6

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- 136** Firms are required to establish policies for audits of financial statements of listed entities to have an EQC review conducted by an EQC reviewer. Firms must also establish criteria to determine when other audits require an EQC review. An EQC review involves objective evaluations of the significant judgments made by the engagement team and the conclusions reached in formulating the auditor's report. An effective EQC review is an important engagement-level quality control. EQC reviews are also a key aspect of the monitoring component of a firm's system of quality control.

Issues

- 137** We recognize the importance of the EQC review and the public interest importance ascribed to it by certain stakeholders. The ISA Implementation Monitoring project has however identified concerns that the requirements in ISA 220 and ISQC 1 regarding EQC reviews are not sufficiently robust, and similar concerns have been expressed by audit oversight bodies. Issues have been identified with respect to the following areas:

- The appropriateness of the criteria established by firms to determine which engagements are subject to an EQC review, with a view that insufficient focus is being placed on entities of particular public interest that are not listed entities.⁸⁴
- The selection of the EQC reviewer, including the qualifications, experience and objectivity of the individual selected to perform the EQC review, and consideration of the reviewer's own inspection results.
- The timing of the performance of the EQC review, specifically with respect to when the EQC reviewer becomes involved in the EQC review and the time allocated to the EQC reviewer for the performance of the review.
- The depth and the focus of the review, specifically highlighting a perception that, in some cases, the EQC reviewer paid insufficient attention to the assessment of and response to areas of significant risk or significant judgments made by the engagement partner and the engagement team, including how, and in which areas of the audit, the engagement team utilized ADMs.
- The robustness of the documentation of the review, including citing the documents reviewed, the issues raised as part of the review and the disposition of those issues.

- 138** Since ISA 220 and ISQC 1 were finalized, the US Public Company Accounting Oversight Board (PCAOB) has issued AS 7.⁸⁵ A review of AS 7 has highlighted differences from the extant requirements in ISQC 1 and ISA 220, which may be potential areas for improvement in our standards. These include:

- An objective of the performance of an EQC review.
- A requirement for an EQC reviewer to be independent, perform the review with integrity and maintain objectivity in performing the review.
- A requirement for a "cooling off" period for an EQC reviewer that had previously been involved in the engagement.
- A requirement that focuses the EQC reviewer to review specific areas of the engagement, such as areas of significant risk or significant judgment.
- The concept of highlighting instances where the EQC reviewer found significant or material deficiencies in the work performed by the engagement team.

- 139** Application material in ISQC 1 explains that an EQC reviewer does not otherwise participate in the engagement during the period of review.⁸⁶ However, there is insufficient clarity in respect of what the period of review and participation means in this context.

We have been called upon to strengthen engagement quality control reviews, given their public interest importance.

⁸⁴ ISQC 1, paragraph 35(b)

⁸⁵ PCAOB Auditing Standard (AS) No. 7, *Engagement Quality Review*

⁸⁶ ISQC 1, paragraph A49

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- 140** SMPs have identified challenges in complying with certain of the existing requirements in ISQC 1 and ISA 220. SMPs may need to use third-party resources as EQC reviewers. There is often limited availability of adequately qualified individuals willing to take on the additional level of risk to perform the role of an EQC reviewer, and where these individuals are identified, they are costly. The possible expansion of engagements that would require an EQC review beyond audits of listed entities (see paragraph 143) could add further to the challenges for SMPs that have to use third-party resources as EQC reviewers.

References to Existing Requirements and Application Material

- 141** In addition to requiring EQC reviews for audits of financial statements of listed entities, ISQC 1 includes requirements and application material for a firm to develop policies and procedures for:
- The selection of other engagements that meet the criteria established by the firm and that should therefore be subject to an EQC review;
 - The nature, timing and extent of the EQC review;⁸⁷ and
 - Determining the eligibility of personnel to perform the role of the EQC reviewer.⁸⁸
- 142** ISQC 1⁸⁹ and ISA 220⁹⁰ include requirements and application material discussing the engagement partner's responsibilities and the EQC reviewer's responsibilities with respect to the performance of the EQC review (including what the review should include and specific incremental requirements for EQC reviews for audits of financial statements of listed entities), including documentation requirements.⁹¹

Possible Actions to Address the Issues

- 143** Strengthening the requirements and application material in ISQC 1 and ISA 220 related to EQC reviews may contribute positively to enhancing audit quality. In our discussions, we have identified the following possible actions to address the issues:
- Expanding the types of engagements that would require an EQC review beyond audits of listed entities. These changes may result in other entities of particular public interest, for example, financial institutions (such as banks, insurance companies, and pension funds), being subject to EQC review requirements. This may be achieved by one, or a combination, of the following:
 - Elevating the application material in ISQC 1 and ISA 220 concerning criteria for selecting those engagements subject to EQC review to requirements.
 - Strengthening the requirements and application material in ISQC 1 in relation to the establishment of criteria by the firm for selecting those engagements that require an EQC review.
 - Adding a new requirement, or clarifying the existing requirement, to focus on the selection of engagements for review based on identified risks of the engagements, such that engagements with higher audit risk or, if a firm is using a QMA, those that pose greater risk of negatively affecting the firm's ability to meet its quality objectives would be more likely to be selected.

⁸⁷ ISQC 1, paragraphs 35–36 and A41–A43⁸⁸ ISQC 1, paragraphs 39–41 and A47–A51⁸⁹ ISQC 1, paragraphs 37–38 and A44–A46⁹⁰ ISA 220, paragraphs 19–21 and A23–A31⁹¹ ISQC 1, paragraph 42, and ISA 220, paragraph 25

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- Requiring an EQC review for audits of entities of particular public interest other than listed entities. We could explore setting a minimum definition or describing characteristics of entities of particular public interest other than listed entities that would be required to be taken into account in setting criteria for EQC reviews (for example, entities with a large number and wide range of stakeholders and considering the nature of entities with certain characteristics, including size of the business). We recognize however the difficulty of defining public interest entities (PIEs) on a global basis, given the various definitions or interpretations across different jurisdictions.
- Strengthening the requirements and application material regarding the selection of the EQC reviewer, for example, elevating the application material in ISQC 1 concerning policies and procedures to maintain objectivity of the EQC reviewer to requirements.⁹² We may consider a requirement for the firm to establish a policy that defines the period of time that an individual who had previously been involved in the audit, including in the role of the engagement partner, would not be eligible to fill the role of the EQC reviewer.
- Strengthening the documentation requirements in ISA 220 to include the timing and the substance of the EQC review procedures performed, and significant or substantive discussions between the engagement partner and the EQC reviewer.⁹³
- Adding application material to ISA 220 for the use of subject-matter experts or other qualified individuals, separate from subject-matter experts that assisted the engagement team, to assist an EQC reviewer where appropriate. When an EQC review is not performed, subject-matter experts or other qualified individuals could be used as part of a pre-issuance review (see paragraphs 148 and 156).
- Strengthening the requirements and application material in ISA 220 by further specifying the nature and extent of matters to be considered by the EQC reviewer. This may include, for example, emphasizing:
 - The importance of the EQC reviewer's responsibilities for assessing the judgments made by the engagement partner and the engagement team in determining the areas of significant risk and procedures performed in responding to those significant risk areas.
 - The need for involvement in the review of components in a group audit situation as appropriate.

144

Given the importance and value placed on the role of the EQC review by stakeholders, particularly investors and regulators, we are considering alternatives to give further prominence to, and emphasize the importance of, the EQC review. In addition to the possible actions above to strengthen requirements and application material, we welcome stakeholder views on the following considerations in this context:

- Development of a separate EQC review standard, which could have the following advantages and disadvantages:

Advantages

- Greater prominence of the contribution of the EQC review to audit quality through increased focus being provided by the use of a separate standard.
- May allow for greater elaboration of requirements and application material for an EQC review (including proportionate application or application to other types of assurance or related services engagements).
- May help address the issues of scalability of ISQC 1.

⁹² ISQC 1, paragraph A49

⁹³ ISQC 1, paragraphs 24–25

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Disadvantages

- Linkages to, and with, the overall framework of ISQC 1 may be missed, particularly if a QMA is introduced in ISQC 1.
- Potential for duplication.
- Undue prominence on an EQC review in relation to other important factors in quality control, in particular the role of the engagement partner and other reviews that may be undertaken (see paragraph 85).
- The possibility of providing transparency in the auditor's report, for example, by communicating in the auditor's report as to whether the engagement was subject to an EQC review. However, any such communication would need to take into account the fact that users of the auditor's report could inadvertently form a negative view about the quality of an audit that has not been subject to an EQC review, notwithstanding that such an audit may not have met the firm's criteria for selection.

145 To address concerns regarding the role of the EQC reviewer, an appropriate distinction between the responsibilities of the engagement partner and those of the EQC reviewer must be maintained in light of the objectives of the respective roles. The role of the EQC reviewer in relation to the engagement partner could be clarified in ISQC 1 and ISA 220. Changes to ISQC 1 and ISA 220 should not result in the requirements and responsibilities of the EQC reviewer exceeding those of the engagement partner.

146 To date, we have heard mixed views about possible amendments to ISA 260 (Revised)⁹⁴ to require the engagement partner's communications with those charged with governance of the entity to include communications that the engagement is subject to an EQC review and the role and function of the EQC review. In addition, we have heard mixed views regarding whether, and in what circumstances, communication between the EQC reviewer and those charged with governance of the entity may be appropriate.

QUESTIONS

Engagement Quality Control Reviews and Engagement Quality Control Reviewers QC6

Monitoring and Remediation

147 Important aspects of an effective system of quality control are policies and procedures providing for regular assessment of the adequacy and effectiveness of that system, including a mechanism by which the system is evaluated and modified, as appropriate, when deficiencies are identified.

148 In addition to EQC reviews of some audits, many firms perform other types of reviews at different stages of an audit that are focused on achieving quality. Such reviews have the objective of identifying and correcting potential engagement deficiencies, but do not take the place of the EQC review. ISQC 1 does not explicitly contemplate the use of these other internal reviews in monitoring the firm's system of quality control or as a source of identifying situations where remedial action might be necessary. Examples of these types of reviews include:

- "Pre-issuance" review – of the work being performed by the engagement team prior to the issuance of the auditor's report. Such a review is not an EQC review. A pre-issuance review is performed by appropriately experienced and qualified individuals who are not engagement team members. For example, in the context of an audit engagement, a pre-issuance review may focus on the audit procedures performed and the documentation thereof by the engagement team, or may focus on a particular aspect of the audit affecting a particular or multiple engagements.

⁹⁴ ISA 260 (Revised), *Communication with Those Charged with Governance*

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- “Post-issuance” review – of the work performed by the engagement team subsequent to the issuance of the auditor’s report. A post-issuance review is a review of the procedures performed or the engagement team’s documentation thereof that is performed by appropriately experienced and qualified individuals who are not engagement team members. The post-issuance review may cover the entire engagement or a targeted area of the engagement.

149 Since ISQC 1 was developed, the nature and extent of audit regulation has expanded in many jurisdictions around the world. External inspections and related findings are far more common today. Audit regulators expect firms to investigate and understand the root causes of inspection findings, and to use them as the basis for determining remediation activities and assessing the effectiveness of those actions.

Issues

- 150** While ISQC 1 contains requirements related to monitoring of a firm’s system of quality control, the ISA Implementation Monitoring project and feedback from stakeholders have highlighted areas where ISQC 1 could be improved. For example, regulators and audit oversight bodies have:
- Increased demands on firms to take actions to understand the causal factors of inspection findings (i.e., perform “root cause analysis”) and respond to inspection findings related to individual engagements as a means of improving audit quality;
 - Emphasized the importance of investing the appropriate time and resources to both internal inspections of individual engagements and of the firm’s system of quality control;
 - Noted the importance of communication throughout the firm of appropriate information including, findings resulting from inspections of the firm’s system of quality control; and
 - Noted that internal inspections of engagements and the firm’s system of quality control should focus on key judgments and risks and not only on compliance aspects.

The assessment of the effectiveness of the firm’s system of quality control is broader than the performance of internal inspections of individual engagements.

- 151** ISQC 1 requires communication of the firm’s quality monitoring results. However, it does not explicitly include requirements for firms to develop policies and procedures to address and respond to the results of inspections performed by external inspectors, such as:
- The communication of findings from external inspections related to both individual engagements and the firm’s system of quality control.
 - How those findings may impact other engagements not selected for inspection.
 - Documentation requirements regarding the consideration of findings from inspections of individual engagements and the firm’s system of quality control, including evaluation and resolution thereof.
 - Guidance on the implementation of systems or policies and procedures that focus on continual improvement, including the performance of a root cause analysis.

SMP Perspective

- 152** SMPs have identified monitoring, including compliance with the requirements set out in ISQC 1, as one of the most challenging aspects of a system of quality control to implement. Challenges stem largely from resource constraints, funding the cost of compliance, and dealing with the requirement for a person external to the engagement to perform the internal inspection.⁹⁵

There is an increasing expectation that firms will take action to understand the causal factors of internal and external inspection findings and respond appropriately.

⁹⁵ ISQC 1, paragraph 48(c)

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Some SMPs have highlighted concerns arising from the impact of requirements for various reviews, such as EQC reviews (including when resources outside of the firm are needed), external resources for monitoring requirements on ISQC 1 and peer review or inspection by relevant institutions. These requirements can result in the documentation of the same audit being reviewed multiple times, leading to questions regarding whether the layers of quality control, combined with external inspections, when taken in total, may be excessive in certain circumstances.

References to Existing Requirements and Application Material

154

ISQC 1 requires firms to have monitoring processes to provide reasonable assurance that the policies and procedures relating to the firm's system of quality control are relevant, adequate and operating effectively.⁹⁶ ISQC 1 requires that at least one engagement for each engagement partner within the firm is evaluated on a cyclical basis, subsequent to the completion of that engagement, and that any identified deficiencies are evaluated, communicated and remediated.⁹⁷ These requirements and related application material currently only pertain to internal inspections.

155

Although ISQC 1 does provide requirements in respect of complaints and allegations where the work performed by the firm fails to comply with professional standards and applicable legal and regulatory requirements and where there is non-compliance with the firm's system of quality control, the link to remediation of external inspection findings through this requirement and related application material is not explicit.⁹⁸

Possible Actions to Address the Issues

156

Strengthened requirements and new application material within ISQC 1 could lead to improved audit quality with firms achieving greater consistency in practice to respond to all feedback on quality control, including internal and external inspection findings of a firm's system of quality control and of individual engagements, as well as other quality reviews that a firm might perform. This could include strengthening the requirements and enhancing the application material for:

- An analysis of any external findings and appropriate responses thereto, in the same way that internal findings are considered;
- Consideration of whether inspection findings would have implications for other engagements as well as the firm's system of quality control;
- Consideration of how the performance of pre-issuance reviews and post-issuance reviews, and the results thereof, may factor into the firm's system of quality control; and
- The role and results of external reviews and how these interact with the internal monitoring system.

157

In addition, ISQC 1 could require:

- (a) Obtaining an understanding of the causal factors of audit deficiencies identified by inspections and other reviews (such as EQC reviews, pre-issuance reviews, post-issuance reviews etc.), including consideration of information gathered at the engagement level regarding each audit deficiency.
- (b) Policies and procedures to clarify the necessary actions regarding analysis of audit deficiencies and corrective measures may help prevent the circumstances giving rise to that deficiency from occurring on future engagements (e.g., policies and procedures to require that audit deficiencies should be subject to further analysis by a firm to obtain an understanding of why a deficiency occurred, and that corrective measures that should be designed, implemented and monitored to assess their effectiveness).

Any such changes to ISQC 1 may impact aspects of ISA 220 regarding whether understanding causal factors identified by the engagement team in conjunction with supervision and review activities may further positively impact audit quality.

⁹⁶ ISQC 1, paragraphs 48 and A64–A68

⁹⁷ ISQC 1, paragraphs 49–54 and A69

⁹⁸ ISQC 1, paragraphs 55–56 and A70–A72

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- 158** Equally as important to understanding the causal factors of audit deficiencies related to inspection findings is monitoring by firm leadership of the effectiveness and appropriateness of the remedial actions. Monitoring by firm leadership might result in the need for new or improved responses to address the audit deficiencies identified, thereby continually improving the effectiveness of the system of quality control. In this regard, additional requirements or application material or clarifications of existing requirements and application material could be added to ISQC 1. For example, existing requirements in ISQC 1 could be strengthened to explicitly require firms to evaluate the effectiveness of its overall system of quality control.
- 159** The use of a QMA by the firm would create an opportunity to provide a stronger link to monitoring and remediation within the firm's system of quality control and further promote a focus on continuous improvements to quality.

QUESTIONS

Monitoring and Remediation QC7

Engagement Partner Performance and Rewards Systems

Issues

- 160** The engagement partner performs a pivotal role in an audit and is responsible for the overall quality on each audit engagement to which the partner is assigned.⁹⁹ In the context of audit quality, some have suggested that it may be appropriate to provide that an element of a partner's remuneration should be variable and include incentives or sanctions more closely linked to whether audit quality has been achieved.
- 161** ISQC 1 does not include requirements or application material in respect of human resource policies governing fixed and variable remuneration for partners or remuneration based on the provision or cross selling of additional services beyond those contracted for.

SMP Perspective

- 162** In the case of a sole practitioner or firm that has very few partners and perhaps only one or very few partners performing audits, inclusion of a requirement that a component of an audit partner's remuneration be linked to incentives related to achieving audit quality may be challenging to implement and may have unintended consequences for SMPs.

References to Existing Requirements and Application Material

- 163** ISQC 1 does not have any requirements that address compensation – but rather addresses compensation in the context of other requirements. For example, application material in ISQC 1 notes the importance of promoting an internal culture based on quality, which includes establishing policies and procedures that address compensation, including incentive systems and the assignment of responsibilities so that commercial considerations do not override the quality of the work performed.¹⁰⁰
- 164** ISQC 1 includes compensation as a personnel issue relevant to the firm's policies and procedures related to human resources.¹⁰¹
- 165** The IESBA Code includes compensation safeguards against a member of the audit team being compensated for selling non-assurance services to that audit client.¹⁰² In addition, some jurisdictions have various rules and regulations regarding this topic.

⁹⁹ ISA 220, paragraph 8

¹⁰⁰ ISQC 1, paragraphs A5 and A24–A25

¹⁰¹ ISQC 1, paragraph A24

¹⁰² IESBA Code, paragraphs 290.225–226

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Possible Actions to Address the Issues

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- 166** We do not believe ISQC 1 should be used as a vehicle to mandate the structure of an engagement partner's remuneration, specifically with respect to compensation that may be withheld and paid out in the longer term based on the results of pre-determined criteria in the intervening period.
- 167** However, similar to some governance frameworks, ISQC 1 could specifically require that firms, as part of their human resource policies and procedures, have a policy in place governing remuneration of partners and other key staff, with particular attention on individuals within firm leadership that have responsibility for audit quality. Depending on the circumstances of the firm, additional oversight over the remuneration of senior firm leadership may be necessary (e.g., through the use of a remuneration committee).
- 168** Remuneration of partners and other key staff could include incentives to address audit quality, such as profit-sharing based on achieving audit quality or sanctions when audit quality is not achieved. Assessing audit quality could include consideration of the results of internal and external inspection of engagements, including the severity of any related findings.
- 169** ISQC 1 could seek to address linkage between compensation and audit quality. Acknowledging that audit quality is one of many factors that should be considered as part of a remuneration structure and including examples in ISQC 1 (such as describing factors that may address how inspection findings, or the lack thereof, related to audit quality) may provide useful context on how the linkage between audit quality and compensation may be achieved.
- 170** To achieve greater consistency with the spirit of the requirements in the IESBA Code,¹⁰³ ISQC 1 could also include new application material relating to threats related to the provision of non-assurance services to audit clients and safeguards needed with respect to related compensation.

QUESTIONS

Engagement Partner Performance and Rewards Systems QC8

Human Resources

- 171** The knowledge, skills and competence of a firm's employees and the manner in which those employees are assigned to an engagement are essential to achieving audit quality and therefore would be an important consideration in the firm's determination of quality risks in establishing a QMA. Continuity planning (which typically encompasses loss of key employees, loss of an office, the introduction of sanctions affecting key personnel or the firm and mandatory rotation of the engagement partner) is an additional consideration that impacts the knowledge, skill and competency of the firm's employees.

Issues

- 172** Effective continuity planning involves developing and maintaining an appropriate structure for managing people within the firm that supports the firm's commitment to attracting, developing, motivating, retaining and rewarding personnel in line with the firm's strategy and quality objectives. However, financial considerations may undermine a firm's commitment and ability to effectively plan for continuity of appropriately experienced and trained staff. It is therefore important that firms are not unduly influenced by the need to meet target financial metrics, such that the firm's policies do not allow for appropriate investment in training and education of personnel or that result in insufficient partner hours being allocated to an engagement.
- 173** Regulators and audit oversight bodies have noted concerns with the documentation of some firms' procedures to support the assessment of partner and staff competence both during recruitment and assignment of staff to the engagement team.

¹⁰³ IESBA Code, paragraph 290.32

SMP Perspective

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- 174** SMPs have cited challenges in their ability to attract and retain appropriate talent, while acknowledging that these cannot be resolved through auditing or quality control standards. A recent SMP Survey we conducted highlighted difficulties with the performance of staff reviews, with a view expressed that formal documentation of staff reviews may not be necessary in every case, such as when the engagement partner gives continual feedback to staff.

Reference to Existing Requirements and Application Material

- 175** ISQC 1 includes requirements and application material around personnel issues relevant to a firm's human resources policies and procedures.¹⁰⁴ For example, ISQC 1 notes that the personnel issues of career development and promotion are relevant to a firm's human resources policies and procedures, but does not provide detail as to what is envisaged.

Possible Actions to Address the Issues

- 176** Clarification to the application material in ISQC 1 that financial considerations should not undermine quality objectives may be helpful. Additional application material to support the requirements addressing career development and promotion could highlight that part of career development and promotion is providing timely and informative performance appraisals and evaluations; however, how such evaluations are performed may be based on the facts and circumstances of the firm.
- 177** Additional application material to support the requirements for a firm to have sufficient personnel with appropriate competence, capabilities and commitment to ethical principles could highlight the importance of maintaining evidence of the procedures performed to address the requirements.
- 178** Continuity planning requirements may be an appropriate addition to ISQC 1, in particular in the context of the firm assessing the risks of not being able to meet its quality objectives, and what responses may be necessary considering the particular facts and circumstances.

Engagement Partner Competency

Issues

- 179** In order to properly fulfill their responsibilities in accordance with the ISAs, it is essential that engagement partners have the necessary skills and competence. ISQC 1 and ISA 220 do not contain detailed requirements or application material that specifically address the necessary skills and competence that engagement partners should have. The IAESB recently issued IES 8 (Revised).¹⁰⁵ This standard focuses on the professional competence requirement for engagement partners who have responsibility for audits of financial statements. The standard is organized by areas of competence, including: Technical Competence, Professional Skills and Professional Values, Ethics and Attitudes. The considerations in these areas provide useful guidance, through the learning outcomes, as to the characteristics necessary for an engagement partner in fulfilling the responsibilities under the ISAs.

References to Existing Requirements and Application Material

- 180** IES 8 (Revised) notes that competence in Interpersonal and Communication Skills includes effective and appropriate communication with the engagement team, management and those charged with governance of the entity.¹⁰⁶

¹⁰⁴ ISQC 1, paragraphs 29–31 and A24–A26

¹⁰⁵ IES 8 (Revised), *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements (Revised)*

¹⁰⁶ IES 8 (Revised), Professional Skills, (j) Interpersonal and communication

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- 181** Paragraph A13 of ISA 220 notes that discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team. However, the concept of “more experienced team members” can be open to interpretation, as it is not defined in ISA 220.
- 182** In the area of Professional Skills, and specifically personal competencies, IES 8 (Revised) includes the promotion of and undertaking lifelong learning, acting as a role model to the engagement team and acting in a mentoring or coaching capacity to the engagement team.¹⁰⁷
- 183** Within Professional Skills, IES 8 (Revised) notes the evaluation of whether the engagement team, including the auditor’s experts, collectively has the appropriate objectivity and competence to perform the audit and manage audit engagements by providing leadership and project management of the engagement teams.¹⁰⁸ ISA 220 addresses the engagement partner’s responsibility to be satisfied that the engagement team has appropriate competence and capabilities.¹⁰⁹
- 184** ISQC 1 acknowledges that competence can be developed through coaching by more experienced staff, for example, other members of the engagement team.¹¹⁰
- 185** ISA 220 currently requires that the engagement partner remain alert for non-compliance with relevant ethical requirements by members of the engagement team,¹¹¹ and subsequently explains in paragraph A4 that the IESBA Code includes objectivity as one of its fundamental principles.
- 186** IES 8 (Revised), in the competence area of Professional Values, Ethics and Attitudes, highlights a commitment to the public interest, and more specifically, the promotion of audit quality in all activities with a focus on protecting the public interest.¹¹²

Possible Actions to Address the Issues

- 187** We could undertake a more detailed review of the relationship between IES 8 (Revised) and our quality control standards (ISQC 1 and ISA 220) to determine whether greater attention can be given in our quality control standards to the requirements in IES 8 (Revised) by:
- Updating application material in ISA 220 to explain the reference to “more experienced team members,” and to emphasize the responsibility of the engagement partner for setting the appropriate tone for engagement team discussions such that all engagement team members feel comfortable raising questions.
 - Strengthening the requirements or enhancing the application material that discusses the responsibilities of the engagement partner in relation to relevant ethical requirements by members of the engagement team.
 - Updating application material in ISQC 1 or ISA 220 concerning the engagement partner responsibilities to include the concepts of leading by example and of mentoring.
 - Updating requirements and application material in ISA 220 to make the engagement partner’s responsibilities for leadership and project management (including the assessment of the competence and objectivity of the engagement team) more explicit.
 - Considering whether ISQC 1 should explicitly highlight the competencies in IES 8 (Revised) in the areas of Interpersonal and Communication Skills, Professional Skills and Professional Values, Ethics and Attitudes.

QUESTIONS

Human Resources and Engagement Partner Competency QC9

¹⁰⁷ IES 8 (Revised), Professional Skills, (k) Personal

¹⁰⁸ IES 8 (Revised), Professional Skills, (l) Organizational

¹⁰⁹ ISA 220, paragraph 14

¹¹⁰ ISQC 1, paragraph A25

¹¹¹ ISA 220, paragraph 9

¹¹² IES 8 (Revised), Professional Values, Ethics and Attitudes, (m) Commitment to the Public Interest

Transparency Reporting

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188 Firms are increasingly issuing publicly available reports that provide transparency regarding certain elements of the firm and its operations, also referred to as transparency reports. Current practices and requirements for such reporting vary significantly between jurisdictions.¹¹³ Transparency reports are sometimes required by law or regulation, although some firms are issuing them on a voluntary basis. The reports may involve reporting on matters beyond the firm's system of quality control or other areas addressed by our standards. Global organizations like the International Organization of Securities Commissions (IOSCO) are interested in the topic.¹¹⁴ These organizations can influence globally accepted forms of transparency reporting and the elements that reports should contain.

189 We believe we should seek to understand the demand and requirements for transparency reporting around the world, and how investors, regulators and others are using these reports. Doing so will enable us to understand whether establishing requirements to address elements of transparency reporting – for example, requiring firms to provide greater insight into their system of quality control and its effectiveness – could be feasible on a global basis and, if so, how that might be done.

190 To date, we have discussed the following matters:

- (a) A number of jurisdictions already have national law or regulation that require transparency reporting that includes information about the firm's system of quality control. More consistent reporting of this nature across jurisdictions would likely be valuable to users of the reports and therefore in the public interest. However, in the absence of globally consistent transparency reporting requirements, it may be challenging or not feasible for us to set requirements or develop meaningful guidance addressing firm's responsibilities for such reporting in an international standard. It may therefore be most appropriate for regulators and audit oversight bodies to establish specific transparency reporting requirements, as these can then be enforced and adapted at the jurisdictional level, and for NSS to develop the related requirements for auditors in those jurisdictions.
- (b) Transparency reporting is an area where practice is likely to continue to evolve to meet the needs of users of such reports. Trying to establish requirements related to firm transparency reporting could inhibit innovation in this area and possibly result in less useful information being provided to stakeholders, in particular if these reports are viewed as providing "boilerplate" information. However, we may be in a position to facilitate the evolution of transparency reporting in a positive way, for example through:
 - Facilitating ongoing dialogue on the topic and encouraging academic research to explore the impact of transparency reporting on audit quality;
 - Issuing guidance to assist firms in describing their systems of quality control within the transparency reports required in their jurisdiction or that might be issued on a voluntary basis; and
 - Developing a thought piece or other non-authoritative material on the topic.

QUESTIONS

Transparency Reporting QC10


QUESTIONS

Overall Questions for Quality Control QC11–QC14

¹¹³ Transparency reports are required in the European Union for firms that carry out statutory audit(s) of PIEs. These reports are required to include at least (i) information related to the legal structure and ownership of the firm; (ii) a description of the network the firm belongs to (if applicable); (iii) governance structure of the firm; (iv) a description of the firm's internal system of quality control; (v) an indication of when the last quality assurance review took place; (vi) a list of PIEs for which the firm has carried out statutory audits during the preceding financial year; (vii) a statement regarding the firm's independence practices; (viii) the continuing professional education policy of auditors within the firm; (ix) firm financial information; and (x) information on basis for partner compensation. Transparency reports are also required or more commonly used in Australia, Japan and Turkey and are being considered elsewhere.

¹¹⁴ In November 2015, IOSCO published a report on *Transparency of Firms that Audit Public Companies* (<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD511.pdf>), which considers practices employed by audit firms and provides a Guide for transparency reporting.

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HOW CAN WE STRENGTHEN OUR STANDARDS ADDRESSING GROUP AUDITS?

GROUP AUDITS – EXTRACT FROM 2015–2016 WORK PLAN

The feedback received by the IAASB in developing its *Work Plan for 2015–2016* indicated that there are issues and concerns in the following areas related to group audits:¹¹⁵

In relation to the application of ISA 600 in particular circumstances—Matters relating to:

- “Letterbox audits”,¹¹⁶ i.e., whether ISA 600 applies in the situation where the group parent entity is registered in one jurisdiction, which is where the group auditor is based, but the group’s operations, accounting records and management are located in a different jurisdiction.
- The practical implications of applying ISA 600 in certain circumstances, such as when access to the relevant information is restricted (in particular when a significant component is an equity investment or joint venture) and in “funds of funds” structures.
- Whether and, if so, how ISA 600 applies in situations where shared service centers are used.

In relation to auditor performance in accordance with ISA 600—Concern has been expressed about:

- The extent of the group auditor’s involvement in the work of the component auditor (the amount and scope of work needed by the group auditor in relation to the component including the audit evidence needed, access to the workpapers of the component auditor, and clarification of various aspects relating to “significant components”);
- Communication between the group auditor and the component auditor;
- Application of the concept of component materiality;
- Identifying a component in complex situations; and
- Work effort of the component auditor.

Issues arising in the Quality Control and Professional Skepticism initiatives may also be relevant to this work.

¹¹⁵ Feedback included the findings from the our ISA Implementation Monitoring project, a stakeholder survey on work plan priorities, consultation on our proposed Work Plan for 2015–2016, and input from outreach to key stakeholders.

¹¹⁶ Situations where the engagement partner is not located where the majority of the audit work is performed are referred to by some as audits of “letterbox companies.” *The 2015–2016 Work Plan* for group audits included issues and concerns about matters related to these kinds of audits. However, these issues and concerns are not unique to group audits and are therefore explored further in the Quality Control section of this document (see paragraphs 76–77).

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The matters above present a summary of the initial input to the project on group audits as presented in the *IAASB's Work Plan for 2015–2016*. However, in exploring these matters further, and based on our deliberations and input from the IAASB CAG and from outreach activities, our understanding of some of the issues has evolved, and in some cases the issues have been refined or expanded. The discussion that follows reflects these refinements and expansions.

We are particularly interested in further understanding stakeholder views about possible actions that may be taken (including input on our initial views about those actions). In particular, we are interested in understanding whether and how matters may have been or are being addressed (e.g., because firms have developed internal guidance to address certain aspects of the issues) or whether practical challenges continue to be experienced. We are interested in your views about actions related to group audits that may help emphasize professional skepticism and how the possible actions we have described might be enhanced to better emphasize and support the appropriate application of professional skepticism. Additionally, we are interested in whether there are any specific implications related to SMPs or public sector considerations regarding the issues identified and possible actions we may take.

When exploring changes to the requirements and guidance in the ISAs, we noted that it may be necessary to revisit the relevant definitions in ISQC 1 and the ISAs to determine whether changes are needed.

We have organized the matters relating to group audits as follows:

Strengthening and Clarifying How the ISAs, Including ISA 220, Apply in a Group Audit
(see paragraphs 191–203.)

Acceptance and continuance of the group audit engagement (see paragraphs 204–217.)

Communications between the group engagement team and component auditors
(see paragraphs 218–225.)

Using the Work of the Component Auditors

- Issues relating to understanding the independence, competence and capabilities of the component auditors (see paragraphs 226–234.)
- Issues relating to the group engagement team's involvement in the work of the component auditors (see paragraphs 235–242.)

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

- Issues relating to the group engagement team's understanding of the components and identifying significant risks for the group (see paragraphs 243–253.)
- Issues relating to component materiality and other aspects of materiality relevant to group audits (see paragraphs 254–261.)

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)

- Issues relating to audit procedures performed on the component's financial information (see paragraphs 262–273.)
- Issues relating to non-significant components (see paragraphs 274–279.)
- Issues relating to the group engagement team's involvement in the consolidation process (see paragraphs 280–288.)
- Issues relating to subsequent event procedures (see paragraphs 289–292.)

Review and Evaluation of the Work of Component Auditors By the Group Engagement Team

- Issues relating to evaluating the communications from the component auditors and the adequacy of their work (see paragraphs 293–299.)
- Issues relating to the evaluation of the work of component auditors on the group audit engagement and whether sufficient appropriate audit evidence has been obtained (see paragraphs 300–303.)

Other Issues Relating to Group Audits

- The impact of new and revised auditing standards (see paragraphs 304–305.)

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STRENGTHENING AND CLARIFYING HOW THE ISAS, INCLUDING ISA 220, APPLY IN A GROUP AUDIT
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- 191** Many audits today are audits of group financial statements (group audits). Group audits generally involve participation of component auditors¹¹⁷ who perform work on financial information related to components that comprise the group. Component auditors may belong to the same firm as the group engagement partner and group engagement team or to the same network or group of affiliated firms, or they may be from unrelated firms. Group engagement teams face different challenges in determining how to be sufficiently involved in the work of different types of component auditors.
- 192** Other factors may make group audits more complex and challenging. For example, component auditors may work in jurisdictions with different cultures and languages, law or regulation (including independence and ethical requirements), and financial reporting and auditing requirements. Obtaining the necessary access to information or working papers may also be challenging for group engagement teams (see paragraph 97).
- 193** As with any audit conducted in accordance with our standards, all relevant standards apply to group audits. ISA 600 deals with special considerations for group audits, but specifically notes that the group engagement partner applies the requirements of ISA 220 regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial information of components.¹¹⁸
- 194** Some stakeholders view the interaction of the requirements, definitions, and guidance in ISA 600 as limiting its flexibility. Questions have arisen as to how to most effectively apply the standard in certain circumstances. For example, practical challenges may arise in terms of:
- Identifying components (e.g., because of the interaction of the definition of component with the requirements of the applicable financial reporting framework).
 - Determining the nature, timing and extent of the required involvement in the work of component auditors.
 - Addressing matters relating to an entity's use of a SSC.
 - Establishing expectations in relation to consolidations performed at the regional or segment level.
- None of these matters are expressly addressed in ISA 600.
- 195** Significant issues and concerns relating to group audits have also been highlighted by regulators and audit oversight bodies, including concerns about interpretations as to when ISA 600 does or does not apply, and insufficient assessments by group engagement teams of risks of material misstatement and related responses.
- 196** Audit risk in a group audit encompasses the possibility that a misstatement at the component level, or across components is not detected, which might result in the group financial statements being materially misstated. For example, a component auditor may fail to identify (or communicate to the group engagement team) a misstatement that could be material to the group either individually or when aggregated with other misstatements. The group engagement team may fail to evaluate the broader implications of a misstatement identified by a component at either the group level or for affected components.

¹¹⁷ A component auditor is an auditor who, at the request of the group engagement team, performs work on the financial information related to a component for the purpose of a group audit.

¹¹⁸ ISA 600, paragraph 5

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We have heard that scoping a group audit based on the identification of components (and identification of those that are significant) may not always result in an appropriate top-down approach to the assessment of the risks of material misstatement at the group financial statement level, and the planning and performance of appropriate responses to those risks. For example, the requirement to perform an audit of financial information at significant components may not appropriately focus the work of a component auditor on those aspects that are likely to be most significant in relation to the group financial statements (i.e., when the risks of material misstatement related to individual components' financial information vary in significance).

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Given the importance of the identification and assessment of risks of material misstatement and the design of appropriate responses to achieving the outcome of a quality audit, we believe it is essential that the link in ISA 600 to the other standards that are most likely to always be relevant to the planning and performance of a group audit be sufficiently clear. In particular, we believe it is necessary to clarify, and potentially expand on, how a group engagement team is expected to apply the requirements in the standards related to identifying and assessing risks of material misstatement (including in relation to fraud), and responding to those risks. For example, we could:

- Emphasize the challenges in assessing and responding to risks of material misstatement at the group level, including requiring the component auditor to actively address these risks at the component level.
- Emphasize the need for two-way communication with component auditors about identified risks.
- Reinforce the need to appropriately apply professional skepticism.
- Expand on what appropriate responses and outcomes of the component auditor's work could be.

199

ISA 600 addresses the special considerations that apply to the group audit and establishes requirements and guidance for the group engagement partner and the group engagement team. We may find it necessary to develop a new standard for auditors who serve as component auditors, which may be particularly useful to SMPs who may often function in this capacity.

200

In considering necessary changes to the ISAs, we need to take into account that group structures are not consistent. Entities that may appear to have similar structures will typically have unique characteristics. Component auditors will also have different competence and expertise. Therefore, ISA 600 cannot be too prescriptive in setting forth the nature, timing and extent of appropriate involvement of the group engagement team in the work of component auditors – nor can ISA 600 be expected to address all the different approaches that might be appropriate.

201

It is important that the principles-based nature of the ISAs be preserved so that they continue to be "fit for purpose" as structures continue to evolve. In this way, the group engagement partner can continue to manage and organize the audit to respond to specific practical challenges related to the structure of the entity and related circumstances. We believe that linking more clearly to important principles in other ISAs (e.g., relating to appropriate direction, supervision and review, and identifying and responding to identified risks of material misstatement) may better illustrate how ISA 600 would be expected to be applied or adapted in particular circumstances. In particular, we recognize that many issues discussed in the context of our work on professional skepticism and quality control are likely relevant to the revision of ISA 600 – in particular, the group engagement partner's responsibilities for the quality of the group audit.

We recognize that many issues discussed in the context of our work on professional skepticism and quality control are likely relevant to our group audits project.

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- 202** As noted in paragraphs 50–67, consideration is being given as to whether the quality control standards should be revised to incorporate a QMA at the firm level, as well as a more proactive, scalable and robust approach to managing audit quality at the engagement level. For example, there may be a need in ISA 220 to establish more explicit requirements for the engagement partner to more proactively manage quality risks at the engagement level. These changes may also give rise to the need for revisions to ISA 600. We will also consider the implications of a QMA at the firm level for group audits. For example, the existence of a firm-level QMA may impact the engagement level considerations about acceptance and continuance of group audits.
- 203** The rest of this section of this ITC sets out issues that have been identified, and possible actions that we may consider.

QUESTIONS

Strengthening and Clarifying How the ISAs, Including ISA 220, Apply in a Group Audit GA1

ACCEPTANCE AND CONTINUANCE OF THE GROUP AUDIT ENGAGEMENT

- 204** Audit engagements may only be accepted or continued when the engagement exhibits certain characteristics. In particular, and as described in paragraph 71, the engagement partner needs to establish that certain preconditions are present, the responsibility for which rests with management and, where appropriate, those charged with governance.¹¹⁹ These preconditions include obtaining agreement of management that it acknowledges and understands its responsibility to provide the auditor with:
- (a) Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - (b) Additional information that the auditor may request from management for the purpose of the audit; and
 - (c) Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

In a group audit engagement, the group engagement partner needs to establish that these same preconditions are present before accepting or continuing with the engagement. If access to the required information or entity personnel is not, or will not be, available, there is a presumption that the group audit engagement would not be accepted or continued.

- 205** When the group engagement partner makes a decision to accept a new group audit engagement, or continue with an existing engagement, ISA 600 also requires that in applying ISA 220, the group engagement partner is required to determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion.¹²⁰ For this purpose, the group engagement team is required to obtain an understanding of the group, its components, and their environments sufficient to identify components that are likely to be significant components. Where component auditors will perform the work on the financial information of such components, the group engagement partner is required to evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence.
- 206** Issues relating to the responsibilities of the engagement partner, and possible actions to address these issues, are set out in paragraphs 69–86. The effect of these changes on ISA 600 and the responsibilities of the group engagement partner will also need to be considered.

¹¹⁹ ISA 210, paragraph 6(b)(iii)

¹²⁰ ISA 600, paragraph 12

Issues

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207 It has been noted in some inspection findings that there are situations where auditors give inadequate consideration to certain matters that may be relevant to the decision about whether to accept or continue a group audit engagement, and that the documentation of such considerations does not adequately reflect the decision-making process. In this regard, some regulators and audit oversight bodies and others are concerned that group engagement partners, before accepting a new group audit engagement or making a decision to continue an existing engagement, do not obtain a sufficient understanding to be able to be satisfied that they can reasonably expect that sufficient appropriate audit evidence will be able to be obtained.

208 Examples of matters that may not be adequately considered, or appropriately documented, at the acceptance and continuation stage include:

- (a) The ability to access the information that may be required for the group audit, including access to people or information at the components (e.g., access to financial information of the component or to component management). Issues sometimes arise in situations where:
 - Group management may not have the ability to direct management of the component to cooperate with the group engagement team (e.g., when investments are accounted for in accordance with the equity method or when there are other non-controlled entities that are consolidated or included in the group financial statements).
 - Law or regulation, such as those around privacy and confidentiality, may prohibit access by the group engagement team to component management or to component auditors.
- (b) The ability to be involved in the work of the component auditors to the extent necessary to obtain sufficient appropriate audit evidence, including the ability to:
 - Effectively conduct two-way communication with the component auditors throughout the audit and, as considered necessary, have access to their working papers.
 - Be sufficiently involved in the work of the component auditors to be able to effectively take responsibility for the direction, supervision and performance of the group audit engagement, including the work of component auditors.

Issues may also arise when information requested by the group engagement team from a component auditor is not readily available or typically shared outside the component auditor's firm (such as information about the results of internal or external quality reviews that the group engagement team may inquire about as part of a consideration of the competence and capabilities of the component auditors).
- (c) The impact on the group audit arising from "environmental" issues relating to the component or component auditors (e.g., different cultures or customs where components of the group or component auditors are located).
- (d) The impact on the group audit of differing law or regulation relating to the:
 - Entity and its components (e.g., where components prepare financial information using financial reporting standards that are different from the group financial reporting standards); and
 - Group auditor and component auditors (e.g., differing relevant ethical requirements (including independence requirements)).
- (e) The impact on the group audit of complex group structures, including obtaining an understanding of the business rationale for the legal and operational structure of the group and its components. It has also been noted that, going forward, the decision to accept or continue the engagement may also be increasingly affected by mandatory auditor rotation of one or more component auditors.¹²¹

¹²¹ Law or regulation in some jurisdictions now requires mandatory auditor rotation or will do in the near future.

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- 209** Some regulators and audit oversight bodies have also expressed concerns that, in circumstances where the engagement partner is not located where the majority of the audit work is performed, it is not always apparent that the group engagement partner has been sufficiently involved in the process of deciding whether to accept or continue the engagement.

References to Existing Requirements and Application Material

- 210** ISQC 1 requires that firms establish policies and procedures for the acceptance and continuance of engagements, designed to provide the firm with reasonable assurance that the firm will only undertake work where the firm is:
- Competent to perform the engagement and has the capabilities, including the time and resources;
 - Can comply with the relevant ethical requirements; and
 - Has considered the integrity of the client.¹²²
- 211** ISA 220 indicates that, within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement. ISA 220 requires the engagement partner to be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed.¹²³ The requirements of ISA 600 provide additional context to the application of ISA 220 in a group audit engagement, including that the group engagement partner determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion.
- 212** The application material in ISA 600 includes various examples of where the group engagement team may obtain the necessary understanding of the group, its components and their environments when accepting a new, or continuing with an existing, group audit engagement, what matters the understanding may include and how the ability to obtain sufficient appropriate audit evidence may be affected by significant changes.¹²⁴
- 213** ISA 210 requires the auditor to establish that certain preconditions for an audit are present, including the acknowledgement and understanding from management, included in the terms of the engagement, that the auditor will be provided with access to all information that is relevant for the audit¹²⁵ (see paragraph 71).
- 214** Paragraph 13 of ISA 600 addresses situations where the group engagement partner concludes that restricted access will impact the ability to obtain sufficient appropriate audit evidence to support the audit opinion. The requirements include that the group engagement partner should not accept a new engagement where there will be a scope limitation that would result in a disclaimer of opinion on the group financial statements (if the restrictions are imposed by group management) or, if possible under law or regulation, should withdraw from an engagement if it is concluded that it will not be possible to obtain sufficient appropriate audit evidence due to restrictions imposed by group management and the possible effect of this inability will result in a disclaimer of opinion on the financial statements.¹²⁶ Paragraph 13 is supported by application material in paragraphs A14–A19, which covers both situations where the restrictions are imposed because of circumstance and where the component auditors refuse to provide access to relevant audit documentation sought by the group engagement team.

In accepting or deciding to continue a group audit, the group engagement partner is required to determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to support the group audit opinion.

¹²² ISQC 1, paragraph 26

¹²³ ISA 220, paragraph 12

¹²⁴ ISA 600, paragraphs A10–A12

¹²⁵ ISA 210, paragraph 6(b)(iii)

¹²⁶ ISA 600, paragraph 13

Possible Actions to Address The Issues **Agenda Item 8.**
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215 In discussing the responses to address the issues, we identified the following possible actions:

- (a) Strengthening the requirements in ISA 600 to drive earlier identification by auditors of those situations where there is:
 - No reasonable way of obtaining sufficient appropriate audit evidence, and clarifying what to do in such situations (i.e., not accept or continue the engagement, or making it clear to management and those charged with governance that the result will be a disclaimer of opinion so that management can take any actions considered necessary, such as communicating with intended users of the financial statements); or
 - Likely to be significant complexity or difficulty in obtaining sufficient appropriate audit evidence.
- (b) Clarifying the existing application material in paragraphs A10–A12, or providing additional application material, for matters that may need to be considered in obtaining an understanding of the group, its components and their environments, as well as the component auditors, and as required by paragraph 12 of ISA 600 (i.e., to place the group engagement partner in the position of being able to make the decision to accept or continue the engagement on the most informed basis possible). The nature and extent of the understanding required to be obtained may however, need to be explored further, especially as it relates to new engagements where it is necessary to take into account that this understanding is obtained prior to the firm being engaged (i.e., natural limitations to the nature and extent of the understanding will therefore exist, including that the auditor will not be able to consider or leverage knowledge from prior audit engagements).
- (c) Strengthening the link in ISA 600 to the requirements in ISQC 1 that address the firm's acceptance and continuance policies and procedures, and the requirements in ISA 220 that address the engagement partner's related responsibilities for quality at the engagement level. Making these links more direct would reinforce the need for the group engagement partner to consider the competence and capabilities of the component auditors when considering the competence and capabilities of the collective engagement team performing the group audit engagement.¹²⁷
- (d) Emphasizing that the agreed terms of the engagement include that group management agree to the preconditions for the group audit, including agreeing to provide the auditor with access to all information relevant for the group audit (i.e., consistent with ISA 210). For example, application material could be added to explain what "access to information" means in the context of a group audit and the importance of considering what is relevant in the context of understanding the group, its components and their environments. In particular, application material may highlight the importance of considering the effects of complex structures, the existence of non-controlled components, or where law or regulation may restrict access to a component's information. Furthermore, revisions to the standard could also help clarify and emphasize that access to relevant information is a necessary and important consideration in the acceptance or continuance process.
- (e) Providing more clarity about the different circumstances that may lead to access issues. Enhancing the application material for the specific circumstances that may cause problems and providing some examples about how some of the issues may be addressed may help auditors in addressing some known issues. It has been noted that one of the matters that might be addressed in determining whether to accept or continue an engagement is the effect of threats to personal safety that may be present in jurisdictions where a component auditor is located (e.g., including the effects of war or other unrest or outbreaks of hazardous diseases). Other examples could draw from current practices that group engagement teams or component auditors have used to overcome access issues (and we are interested in learning more about these). It is however acknowledged that some of the issues related to access result from situations that revisions or clarifications to the standards will not be able to resolve.

We are interested in learning about current practices that group engagement teams or component auditors have used to overcome access issues.

¹²⁷ Paragraph A8 of ISA 220 provides examples of matters to be considered in the acceptance and continuance of client relationships, including that the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources.

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- (f) Providing more specific considerations related to situations where the component auditors have policies and procedures that are different to those of the group engagement team (or are subject to different law or regulation and professional oversight; have different education and training backgrounds; are members of different professional organizations; use different standards or have different languages and cultures). Additional guidance may include, for example, highlighting the need to consider whether and how such matters affect the group engagement team's ability to be adequately involved in the work of the component auditors (see also the discussion about the quality control aspects relating to networks of firms in paragraphs 106–116).

216

We have considered whether the existing requirement in paragraph 12 of ISA 600 could be strengthened to clarify, or more directly address, that the determination about whether to accept or continue a group audit engagement is based on the group engagement partner's consideration as to whether sufficient appropriate audit evidence is expected to be able to be obtained. Changes to ISA 600 could include:

- (a) Revising the requirement to place greater emphasis on the need for an explicit conclusion that the group engagement partner and group engagement team can fulfill their respective responsibilities relative to the engagement overall, including for the direction, supervision and performance of the work done by component auditors.¹²⁸ Such a conclusion could be based on the consideration of the work that the group engagement partner and group engagement team will perform directly, as well as on their ability to be sufficiently involved in the work of component auditors.
- (b) Providing application material to support the revised requirement, in particular to emphasize the significance of the judgments involved in drawing the conclusion, and highlighting the importance of documenting the relevant considerations. For example, the application material may suggest that the greater the proportion of the group's financial information that is audited by component auditors, the more important it may be for the group engagement team to have documentation that reflects the considerations about how to be sufficiently involved in the work of component auditors.

In exploring these changes, we will also reflect on the appropriateness of the definition of the group engagement team.

217

Strengthening the requirements and clarifying that an appropriately detailed understanding of the group, its components and their environments is required before deciding to accept or continue a group audit engagement could:

- (a) Better assist group engagement partner in making a more informed decision when determining whether or not to accept or continue the engagement.
- (b) Result in earlier identification of issues affecting the ability to obtain sufficient appropriate audit evidence.
- (c) Enhance auditor performance through focusing at an earlier stage on obtaining information that will be relevant to the planning and performance of the rest of the engagement.

QUESTIONS

Acceptance and Continuance of the Group Audit Engagement GA2

¹²⁸ We noted that the PCAOB's standards (PCAOB AU 543, *Part of Audit Performed by Other Independent Auditors*) explicitly requires that the auditor decide whether it is possible to serve as the principal auditor (i.e., the partner in charge of an audit of group financial statements).

Agenda Item 8. AUASB Meeting 22 February 2016 **COMMUNICATIONS BETWEEN THE GROUP ENGAGEMENT TEAM AND COMPONENT AUDITORS**

- 218** Appropriate communications between the group engagement team and component auditors are an important element of a group audit and, in many ways, the foundation to the group engagement team's ability to be sufficiently involved in the work of component auditors. Communications between the group engagement team and the component auditors can take a variety of forms, including, but not limited to:
- (a) Team meetings (in-person or virtual), discussions and e-mail correspondence.
 - (b) Group instructions provided by the group engagement team to component auditors.
 - (c) Clearance memoranda or similar documents presenting component auditor's findings and provided by component auditors' to the group engagement team.

Issues

- 219** Concerns have been expressed that the communication requirements in ISA 600, including those in paragraphs 40 and 41, are not specific enough to result in sufficient and appropriate communication between component auditors and the group engagement team during the planning and performance of a group audit engagement. Specific issues noted include:
- (a) Inadequate communication between the group engagement team and the component auditors during the audit, in particular as it relates to the communications related to the findings of the component auditor. Some stakeholders are looking for more of a 'feedback loop' in the required communications, such that there is more interactive communication required between the group engagement team and component auditor as the group engagement team plans, reviews and assesses the work performed by the component auditor.¹²⁹
 - (b) The necessary communications are not taking place on a timely basis.
 - (c) Group instructions provided by the group engagement team to component auditors may not be clear or appropriate. For example, the group engagement team may send standardized audit instructions to all component auditors and not tailor the instructions for each component auditor based on the applicable facts and circumstances and the work that each component auditor is being asked to perform. This issue is particularly relevant for SMPs who indicate that, when they serve as component auditors for components that are not significant, they sometimes receive standardized instructions from group engagement teams that are designed for significant components and not tailored for the work that they are asked to perform on the non-significant components.
 - (d) The communications back from the component auditor to the group engagement team may not be in the appropriate form for the group engagement team to be able to properly understand and evaluate the information therein. For example, the communications may not be in the same language as that of the group engagement team, may not contain sufficient detail (e.g., may be too summarized or may not adequately or clearly describe the work performed), or may not contain the necessary findings resulting from the work or describe the conclusions of the component auditor in an appropriate manner.

- 220** Issues have been noted by various stakeholders about situations when the group engagement team is aware of non-compliance or suspected non-compliance with laws and regulations that the group engagement team believes may be relevant to the financial information of the component (or the audit work being done by the component auditor), and the component auditor is unaware of such information. If group management or component management refuse to communicate the relevant information to the component auditor, or does not grant

Stakeholders are calling for more of a "feedback loop" in communications between component auditors and group engagement teams.

¹²⁹ Further discussion about the group engagement's team's response to the findings of the component auditor is discussed in paragraphs 266–277.

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permission for the group engagement team to do so, the only possible communication for the group engagement team is to inform the component auditor not to issue the auditor's report on the component's financial statements. The requirement in paragraph 48 of ISA 600 does not provide for the ability of the group engagement team to communicate directly with the component auditor about the non-compliance, or suspected non-compliance, with laws or regulations that may be relevant to the audit of the financial statements of the component's financial statements.

References to Existing Requirements and Application Material

- 221** One of the objectives of a group engagement team is to communicate clearly with the component auditors about the scope and timing of their work on financial information related to the component and their findings.¹³⁰ ISA 600 sets out requirements about the necessary communications to achieve this objective, including the work to be performed, the use to be made of that work, and the form and content of the component auditor's communications with the group engagement team.¹³¹ ISA 600 also sets out matters that the group engagement team should request the component auditor to communicate with regard to the group audit.¹³²
- 222** The communication requirements in ISA 600 were designed to allow for flexibility, based on the many variations in the way group audits are carried out, and are therefore purposely not overly prescriptive. The related application material specifically explains that communications may not necessarily always be in writing, but are still required to take place on a timely basis.
- 223** When component auditors are required to express an opinion on the financial statements of a component, paragraph 48 of ISA 600 requires that the group engagement team request group management to inform component management of any matter that the group engagement team becomes aware of that may be relevant to the financial statements of the component, but of which component management may be unaware. If group management refuses to communicate the information to component management, after discussing the matter with those charged with governance of the group, the group engagement team is required (subject to legal and professional confidentiality considerations) to consider advising the component auditor to not issue the report on the financial statements.

Possible Actions to Address the Issues

- 224** In discussing the responses to address the issues, we identified the following possible actions:
- (a) Strengthening the requirements and enhancing the related application material regarding communications between group engagement teams and component auditors. This may include, for example, placing more emphasis on the need for sufficient and timely two-way communication during the audit, and highlighting the importance of dialogue, whether in-person, telephonic, or through a virtual form, as appropriate, to supplement more formal written instructions and other communications. Additional emphasis or clarity may help the group engagement team better understand the nature, timing and extent of communications with the component auditor that may be necessary and appropriate throughout the engagement. Enhanced requirements and more guidance may also help the group engagement team in better understanding whether:
- Instructions provided to the component auditors have been fully understood and complied with;
 - Communications by component auditors are consistent with the group engagement team's requests and expectations; and
 - The work performed by component auditors is adequate for the group engagement team's purposes.

¹³⁰ ISA 600, paragraph 8(b)(i)

¹³¹ ISA 600, paragraphs 40–41

¹³² ISA 600, paragraph 41

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- (b) As it relates to the possibility of developing a separate standard containing specific requirements and application material directed at component auditors (see paragraph 199 for further discussion), consideration could also be given to more clearly explaining and setting forth the requirements for the component auditor in making and participating in communications to the group engagement team. For example, there could be an emphasis on the need for sufficient, appropriate and timely two-way communication, and for component auditors to determine that there is a sufficiently clear and mutual understanding of the group engagement team's instructions. It could also be made clear that component auditors have a responsibility to bring relevant issues relating to the performance of their work on a component's financial information to the group engagement team in a timely and comprehensive manner.
- (c) Enhancing the supporting application material by explaining in more detail what the requirements are intended to achieve. For example, ISA 600 requires timely communication between the group engagement team and the component auditors, but does not explain what is meant by timely. There is guidance in ISA 260 (Revised)¹³³ that addresses the timing of communications to those charged with governance that could be used as a basis to provide further explanation about timely communications in the context of ISA 600. Enhanced application material could also include examples of different kinds of communications that may be appropriate in different circumstances.
- (d) Adding application material to emphasize the importance of applying the requirements of ISA 230 in documenting significant communications between the group engagement team and component auditors (including two-way dialogue), and not just focusing on the inclusion of written communications in the audit documentation.
- (e) Consideration of whether the requirements of paragraph 48 of ISA 600, or the related application material, need to be revised to better address the ability of the group engagement team to communicate directly with a component auditor or component management when the group engagement team is aware of non-compliance or suspected non-compliance with laws and regulations that may be relevant to the work being done by the component auditor.

225 Revisions to the communication requirements in ISA 600 may improve the group engagement team's involvement in the work of component auditors (including understanding of the component auditors' findings), thereby providing an improved basis for the evaluation by the group engagement partner of the sufficiency and appropriateness of the audit evidence obtained for purposes of the group audit opinion.

QUESTIONS

Communications between the Group Engagement Team and Component Auditors GA3

USING THE WORK OF THE COMPONENT AUDITORS

Issues Relating to Understanding the Independence, Competence and Capabilities of the Component Auditors

226 The group engagement team obtains an understanding of the component auditor when it plans to request the component auditor to perform work on the financial information of the component. This understanding will help the group engagement team determine whether, and to what extent, it can use the work of the component auditor. The group engagement team is still responsible for obtaining sufficient appropriate evidence upon which to base the opinion on the group financial statements. If the group engagement team determines that the work of a component auditor cannot be used, it will need to obtain the necessary audit evidence directly and without using the work of that component auditor. Alternatively, the group engagement team may identify another more suitable component auditor, and use

¹³³ ISA 260 (Revised), paragraphs A40–A41

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the work of that component auditor. In the event that the group engagement team cannot identify a suitable component auditor, and cannot otherwise obtain the necessary audit evidence, it may not be appropriate to agree to accept or continue the engagement. If the acceptance or continuance decision has already been made, it will be necessary to consider whether to withdraw (unless precluded by law or regulation) and, if not, the effect on the auditor's report.

Issues

227

Concern has been expressed about whether, and how, a group engagement team demonstrates the necessary understanding of the component auditor required by paragraph 19 of ISA 600, and the consequential impact on the group engagement team's determination of the nature, timing and extent of its involvement in the work of the component auditors. These concerns apply to situations where the group engagement team and component auditor are subject to common policies and procedures (which are further discussed in paragraphs 106–116) as well as to situations when they are not.

228

As noted previously, there are new and continuing challenges in group audits as group structures become more complex and continue to evolve. Some of these challenges manifest themselves in particular when the group engagement team commences its work to obtain an understanding of the independence, competence and capabilities of component auditors who are situated in a jurisdiction that:

- (a) Does not have similar legal and regulatory requirements as those that are applicable to the jurisdiction where the group engagement team is located; or
- (b) Has different:
 - Oversight regimes.
 - Independence and ethical requirements.
 - Languages or cultures.
 - Licensing or accreditation requirements.

The group engagement team may have difficulty obtaining all relevant information considered necessary in order to properly understand the component auditors. For example, there may be privacy laws or regulations in the jurisdiction of the component auditor that preclude certain information from being shared with the group engagement team, or the risk management policies of a component auditor's firm may not allow sharing of certain information with the group engagement team.

229

Concern has also been expressed about the group engagement team's understanding of the planned use of experts by component auditors when obtaining an understanding about the competence and capabilities of the component auditor, including challenging situations where there is no planned involvement of experts where their involvement would seem appropriate. For example, the tax laws and regulations in a particular jurisdiction may be particularly complex and, therefore, in understanding the competence and capabilities of the component auditor, it may be appropriate or necessary for the group engagement team to understand whether the component auditor plans to involve a tax expert with the necessary skills and who possesses relevant knowledge in that field of expertise. If such an expert is not involved, it may be appropriate for the group engagement team to challenge the component auditor as to why not.

As group structures become more complex and continue to evolve, group engagement teams face new and continuing challenges in obtaining the necessary understanding of the independence, competence and capabilities of component auditors.

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- 230** ISA 600 requires the group engagement team to obtain an understanding of matters relevant to:
- Compliance with ethical and independence¹³⁴ requirements by the component auditors.
 - The component auditors' professional competence.
 - The ability of the group engagement team to be involved in the work of the component auditors so that sufficient appropriate audit evidence can be obtained.
 - The regulatory environment in which the component auditors operates, in particular whether this environment actively oversees auditors.¹³⁵
- 231** ISA 600 precludes the group engagement team from being able to use the work of component auditors that do not meet the independence requirements relevant to the group audit, or in situations where the group engagement team has serious concerns about matters related to competence. Paragraphs A39–A41 provide additional guidance for the group engagement team, including examples about how less serious concerns about competence may be addressed. Additional guidance about independence considerations is provided in the application material to ISA 700 (Revised).¹³⁶
- 232** ISA 220 sets out matters that may be considered by the engagement partner relating to the appropriate competence and capabilities expected of the engagement team as a whole.¹³⁷ Given the interaction between ISA 220 and ISA 600,¹³⁸ this extends to the group engagement partner's consideration of component auditors, and the introduction to ISA 600 therefore notes that the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate competence and capabilities.¹³⁹
- 233** ISA 600 also indicates that the nature, timing and extent of the group engagement team's procedures to obtain an understanding of the component auditors are affected by factors such as the previous experience with, or knowledge of, the component auditor, and the degree to which the group engagement team and component auditor are subject to common policies and procedures. ISA 600 provides examples of such factors, including noting the relevance of considering the consistency or similarity of laws and regulations, professional oversight, education and training, professional organizations and standards and language and culture. ISA 600 notes that different considerations and extent of procedures to obtain the necessary understanding might apply to different component auditors.¹⁴⁰ ISA 600 and ISA 700 (Revised) also contain guidance about ethical requirements that are relevant to a group audit,¹⁴¹ and understanding of the professional competence of the component auditors.¹⁴²

Possible Actions to Address the Issues

- 234** In discussing the responses to address the issues, we identified the following possible actions:
- (a) Including an objective or strengthening the requirements in ISA 600 to clarify that the group engagement team should make an explicit determination about whether it is appropriate to use the work of a component auditor (i.e., based on the group engagement team's understanding of the component auditor, and the nature and extent of the work the component auditor will be requested to perform).

¹³⁴ ISA 700 (Revised) includes a new requirement for auditors to identify the jurisdiction of origin of the relevant ethical requirements to increase transparency relating to the particular audit engagement.

¹³⁵ ISA 600, paragraph 19

¹³⁶ Paragraph A34 of ISA 700 (Revised) notes that "The ISAs do not establish specific independence or ethical requirements for auditors, including component auditors, and thus do not extend, or otherwise override, the independence requirements of the IESBA Code or other ethical requirements to which the group engagement team is subject, nor do the ISAs require that the component auditor in all cases to be subject to the same specific independence requirements that are applicable to the group engagement team. As a result, relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex."

¹³⁷ ISA 220, paragraph A11

¹³⁸ ISA 600 assists the group engagement partner to meet the requirements of ISA 220 where component auditors perform work on the financial information of components (ISA 600, paragraph 5).

¹³⁹ ISA 600, paragraph 4

¹⁴⁰ ISA 600, paragraphs A33–A34

¹⁴¹ ISA 600, paragraph A37

¹⁴² ISA 600, paragraph A38

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- (b) Enhancing, or expanding the application material in paragraph A33 of ISA 600 to result in a more robust challenge by the group engagement team as to whether the component auditor possesses appropriate competence and capabilities (e.g., through placing greater focus or specificity on the factors in the requirements or including additional application material to better support the requirements).
- (c) Enhancing the application material by including more specific examples that address some of the practical challenges that have been identified related to understanding the component auditors' compliance with relevant ethical requirements (including independence), and their competence and capabilities.
- (d) Developing additional application material to address the impact on the understanding of the competence of the component auditors if there are different or no national or jurisdictional licensing requirements.
- (e) Enhancing the application material to more clearly address how group engagement teams can demonstrate the basis for their reliance on common policies and procedures in determining the necessary levels of involvement in the work of component auditors. Such application material would need to address that the group engagement team's consideration would be expected to take into account other relevant factors (e.g., the consistency or similarity of law and regulation, professional oversight, education and training, professional organizations and standards, and language and culture) (see further related discussion in paragraphs 114–116).
- (f) Developing application material to emphasize the need for the group engagement team to understand results of quality control monitoring, and any external quality control reviews for component auditors, irrespective of whether the group engagement team and the component auditors are subject to common quality control monitoring mechanisms.

The necessary involvement of the group engagement team in the work of component auditors depends on a number of interrelated factors and judgments, and will vary from one group audit to the next.

Issues Relating to the Group Engagement Team's Involvement in the Work of the Component Auditors

235 In finalizing ISA 600 as part of our clarity project, we agreed that the requirement for the group engagement team to be involved in the work of the component auditor should be retained, but allowed flexibility for the group engagement team to determine the appropriate nature, timing and extent of such involvement based on the circumstances. In addition, we considered whether to mandate a minimum quantitative threshold for the involvement of the group engagement team in the group audit, but agreed that this would conflict with the risk-based nature of the standard.

236 As discussed in paragraph 70, the group engagement partner takes responsibility for direction, supervision and performance of the group audit engagement.¹⁴³ When component auditors perform work on the financial information of components, and the group engagement team will use this work when obtaining evidence on which to base the group audit opinion, the ISA requires that the group engagement team be involved in the audit work of the component auditors to the extent necessary to obtain sufficient appropriate audit evidence.

237 The group engagement team's involvement in the work of the component auditors depends on a number of interrelated factors and judgments, such as the competence and capability of the component auditor, the expected communications between the group engagement team and the component auditors, the identification of significant components and the determination of the necessary work relating to non-significant components. The appropriate nature, timing and extent of the involvement of component auditors will therefore vary according to the circumstances of each group audit engagement (e.g., considering the significance of the components, the significance of the risks of material misstatement related to the components and the results of the understanding of the component auditors), but it must be to the extent necessary to obtain sufficient appropriate audit evidence in order to form the basis for the opinion on the group financial statements.

¹⁴³ ISA 600, paragraph 11

Issues

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- 238** Some regulators and audit oversight authorities have raised concerns that involvement of the group engagement team in the work of the component auditors is not always adequate, particularly in instances where the group engagement partner is not located where the majority of the audit work is performed. For example, it has been noted in some audit inspection reports that the nature and extent to which the group engagement team specifies or communicates risks of material misstatement, or expected responses, to component auditors varies, resulting in different levels of understanding and potentially different responses. Additionally, ISA 600 does not include guidance about how to deal with situations in which the group engagement team is also performing work at the component level.
- 239** In addition, certain audit inspection reports have noted that the judgments around the nature, timing and extent of the group engagement team's involvement in the work performed by component auditors, and the reasons therefore, are not always clearly demonstrated (including the documentation by the group engagement team of the relevant considerations supporting its conclusions).

References to Existing Requirements and Application Material

- 240** The group engagement partner is responsible for the group audit engagement. Where component auditors will perform work on the financial information of components, as part of the acceptance and continuance of the engagement, the group engagement partner is required to evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to determine whether the evidence obtained is sufficient and appropriate in the circumstances and that it will support the conclusions reached.¹⁴⁴
- 241** ISA 600 requires the group engagement team to determine the type of work to be performed on the financial information of the components (by the group engagement team or by component auditors on its behalf), and to determine the nature, timing and extent of its involvement in the work of the component auditors.¹⁴⁵ For significant components, there is a requirement for the group engagement team to be involved in the component auditor's risk assessment process to identify significant risks of material misstatement of the group financial statements.¹⁴⁶ ISA 600 specifically requires documentation of the type of work to be performed on the financial information of components,¹⁴⁷ and the nature, timing and extent of the group engagement team's involvement in the work of the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditor's audit documentation and conclusions thereon.¹⁴⁸ Guidance about factors¹⁴⁹ that may affect the group engagement team's involvement in the work of the component auditor, as well as examples of forms of involvement, are included in the application material in ISA 600.¹⁵⁰

Possible Actions to Address The Issues

- 242** In discussing the responses to address the issues, we identified the following possible actions:
- Strengthening ISA 600 to provide more clarity as to how the group engagement team determines the nature, timing and extent of the necessary involvement in the work of the component auditors, including more explicit focus on demonstrating why the involvement of the group engagement team is appropriate in light of all relevant considerations and the application of appropriate professional skepticism. However, due to widely varying group structures and variations in component auditors (including as it relates to their competence and expertise), ISA 600 cannot be overly prescriptive

¹⁴⁴ ISA 600, paragraph 12

¹⁴⁵ ISA 600, paragraph 24

¹⁴⁶ ISA 600, paragraph 30

¹⁴⁷ ISA 600, paragraph 50(a)

¹⁴⁸ ISA 600, paragraph 50(b)

¹⁴⁹ ISA 600, paragraph A54; see also the connection between A54 (c) and A33.

¹⁵⁰ ISA 600, paragraph A55

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in setting forth the nature, timing and extent of appropriate involvement of the group engagement team in the work of component auditors, nor can ISA 600 be expected to address all the different approaches that might be appropriate. For example:

- In some cases, it may be appropriate for a group engagement team to undertake site visits to meet with the component auditors and review their working papers in order to be appropriately involved in their work and effectively evaluate their findings.
 - In other circumstances, preparing group instructions and providing them to a component auditor and obtaining a memorandum from the component auditor that describes in sufficient detail the work performed based on the instructions, and the resulting findings and conclusions, may be sufficient for the group engagement team's purposes.
- (b) Strengthening ISA 600, either through clarification or additions to the requirements or application material, as follows:
- Emphasizing the need for greater focus and professional skepticism by the group engagement team on the significant judgments that need to be made about the nature, timing and extent of the involvement of the group engagement team in work performed by the component auditors, and the need for appropriate documentation thereof.¹⁵¹
 - Clarifying the interrelationships between paragraphs 24, 30, A33, A47 and A54 of ISA 600, to assist auditors in better applying professional judgment in determining the nature, timing and extent of their involvement in the work of the component auditors.
 - More explicitly explaining the interactions between the group engagement team and the component auditors in varying circumstances (e.g., in different group structures or in jurisdictions where restrictions on access exist).
- (c) Providing further examples in the application material to illustrate the wide variety of circumstances that may affect the determination of the necessary nature, timing and extent of the group engagement team's involvement in the work of the component auditor. Additional examples may help distinguish the varying levels of involvement of the group engagement team that may be appropriate in different circumstances. These examples may address situations where:
- The component auditors and group engagement team are not subject to common policies and procedures.
 - The component auditors are from different jurisdictions, or are subject to dissimilar laws or regulations.
 - The professional oversight; discipline and external quality assurance; education and training; and professional organizations and standards differ between the component auditor and the group engagement team.
 - The language and culture of the component auditor are different from the group engagement team.
 - The group engagement team also performs work at the component level.

For example, the nature of the group engagement team's involvement in the work performed by the component auditor when they are not subject to the same policies and procedures (or where there are differences in any of the previously mentioned factors) will likely need to be different, and the nature and timing of such involvement may also need to be different. Depending on the circumstances, more detailed instructions and more frequent communications between the group engagement team and component auditors may be necessary as the audit progresses.

We can emphasize the need for greater focus and professional skepticism by the group engagement team in making the significant judgments about the necessary involvement in the work of component auditors.

¹⁵¹ Paragraphs 8(c) and A8 of ISA 230 set out the documentation requirements for the significant professional judgments of the auditor in reaching their conclusions

Agenda Item 8. AUASB Meeting 22 February 2016 **IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT IN A GROUP AUDIT**

Issues Relating to the Group Engagement Team's Understanding of the Components and Identifying Significant Risks for the Group

- 243** The group engagement team is required to identify and assess the risks of material misstatement in the group audit through obtaining an understanding of the entity and its environment (including its internal control).¹⁵² This understanding builds upon the understanding that has been obtained when deciding to accept (or continue) a group audit engagement (and as discussed in paragraphs 204–217).

Issues

- 244** It has been suggested by some stakeholders, including regulators and audit oversight bodies, that more clarity is needed about certain aspects of the understanding the group engagement team is required to obtain about the group, and its environment, in order to be able to appropriately identify and assess the risks of material misstatement for the group engagement, including significant risks. For example, some stakeholders have the view that the understanding of the components and their respective environments that is obtained by the group engagement team is, in some cases, not sufficient to be able to appropriately direct the attention of the group engagement team and component auditors towards the relevant risks of material misstatement that may exist in the group. Challenges identified include being able to appropriately understand and respond to the impact of:

- (a) Issues in multi-jurisdictional audits related to diverse markets and differing cultures.
- (b) Circumstances where the group structures are such that the engagement partner may be located in the jurisdiction of registration or listing of the entity, with the majority of the audit work being performed in another jurisdiction where general and financial management are located, and where the business activities and related processing of transactions take place.
- (c) Very complex or unusual group structures.
- (d) Evolving group structures that make the identification of components, and how to audit the related financial information, more difficult. For example, many entities are increasingly operating in integrated structures, such as situations where the transactions for the group are processed centrally (e.g., through a SSC). It has been noted that it is not clear how ISA 600 applies (or if it applies) to these situations. In some circumstances, the SSC may be treated as a separately identifiable component. In other circumstances, a SSC may not be considered a separate component based on applying the definition of a component as stated in ISA 600. In some cases, the group engagement team might perform the work at a SSC but, in other cases, another auditor may be involved. We note that some confusion exists as to whether or not the involvement of such an auditor is to be considered and treated similar to that of a component auditor (see further discussion on this in paragraphs 96 and 100).

- 245** Issues related to the identification of significant risks and significant components include:

- (a) Risks identified at the component level by the component auditors are sometimes not appropriately considered at the group level (i.e., inappropriate consideration is given as to whether such risks are group-wide risks or whether such risks also exist at some or all of the other components).
- (b) In situations where group-wide significant risks have been identified that relate to all components, including non-significant components where no procedures are planned to be performed, it may be confusing as to where, or to which component, the work related to the significant risk is to be directed in order to appropriately respond to the risk.

Complex, unusual and evolving group structures give rise to challenges in identifying risks of material misstatement and components, including assessing which risks and components are significant.

¹⁵² ISA 600, paragraph 17

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- (c) The interaction of “significant risks” and “significant components”¹⁵³ i.e., how the identification of significant risks at a component impacts the determination as to whether a component is a significant component. Significant components are identified either based on financial metrics or whether components are likely to include significant risks (determined in accordance with ISA 315 (Revised)).¹⁵⁴ As identification and assessment of significant risks is also linked to the identification of significant components, it has been noted that ISA 600 does not provide much detail as to how significant risks that are pervasive to the group (and which therefore potentially exist at all components) are to be taken into account in determining which components are to be considered significant. It has been noted that the relevant definitions may need to be reconsidered.

246 Lastly, in identifying a “significant component,” it has been noted that some uncertainty exists as to what it means to be “of individual financial significance.”¹⁵⁵

References to Existing Requirements and Application Material

247 Although certain aspects of the required understanding of the entity and its environment, including its internal control, are not specifically covered in ISA 600 (e.g., relevant industry, regulatory, and other external factors, including the applicable financial reporting framework), the requirement in paragraph 17(a) (as well as related application material in paragraphs A23–A29) should be applied when obtaining such understanding. Paragraph 18 and the related application material in paragraphs A30–31 address obtaining an understanding that is sufficient to confirm or revise the initial components that are likely to be significant and to assess the risks of material misstatement of the group financial statements.

248 Significant components are identified to help the group engagement partner and group engagement team determine the type of work to be performed on the financial information of components.¹⁵⁶ The requirements for the types of work to be performed in respect of significant components are supplemented by application material about appropriate procedures in different circumstances.¹⁵⁷

249 The requirements for identifying significant risks in an audit engagement are contained in paragraphs 27–29 of ISA 315 (Revised), with related application material in paragraphs A132–A136. Although there are no specific requirements or guidance in ISA 600 for identifying significant risks in a group audit situation, the group engagement team would be expected to refer to ISA 315 (Revised) in this regard in the context of the group audit engagement.

250 ISA 330 requires that, if the auditor has identified a risk as significant, substantive procedures that are specific to that risk be performed.¹⁵⁸ ISA 315 (Revised) also requires that, if the auditor has determined a risk to be a significant risk, the auditor is required to obtain an understanding of the relevant controls, including control activities.¹⁵⁹ Additionally, if the auditor’s plans for further audit procedures include relying on controls over a significant risk, ISA 330 requires that the auditor test those controls in the current period (i.e., as opposed to using evidence from prior audits as the basis for the conclusion about their operating effectiveness).¹⁶⁰

¹⁵³ A “significant component” is described as a component that is of individual financial significance to the group, or that, due to its specific nature or circumstances, is likely to include significant risks of material misstatement in the group financial statements (see paragraph 9(m) of ISA 600)

¹⁵⁴ ISA 600, paragraphs 26–27

¹⁵⁵ Paragraph A5 of ISA 600 provides guidance on identifying components of individual significance, including applying percentages to chosen benchmarks.

¹⁵⁶ ISA 600, paragraphs 26–27

¹⁵⁷ ISA 600, paragraphs A48–A49

¹⁵⁸ ISA 330, paragraph 21

¹⁵⁹ ISA 315 (Revised), paragraph 29

¹⁶⁰ ISA 330, paragraph 15

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- 251** The requirements in ISA 600 and the related application material (as set out in paragraph 247), as well as the overarching requirement in paragraphs 11(a) and A26 of ISA 315 (Revised), would adequately, in our view, require auditors of group financial statements to obtain the necessary understanding of the entity and its environment in order to identify and assess the risks of material misstatement at both the group and component level.
- 252** However, we recognize that improvements are likely needed to ISA 600 to make more explicit reference to the principles, requirements and related application material in ISA 315 (Revised) (related to identifying and assessing risks of material misstatement) and in ISA 330 (related to responding to those assessed risks), so as to better support application of those ISAs in group audit engagements. As noted in paragraphs 191–203, we are considering making the links to the other ISAs more prominent in ISA 600. In making these links, we recognize the need to acknowledge the existence of evolving environments and increasingly complex group structures and, to the extent possible, eliminate constraints that may exist or arise in relation to overly prescriptive definitions or interpretations of such definitions in the context of group audit engagements.
- 253** In discussing the responses to addressing the issues, we identified the following further possible actions:
- (a) Providing additional examples for relevant aspects and principles in ISA 315 (Revised) and ISA 330 that may arise from a group audit (e.g., to address the examples where issues have arisen as described in paragraph 218). These changes may help reinforce that the understanding of the group and its components builds upon the requirements in ISA 315 (Revised), and the responses to the assessed risks of material misstatement are to be framed in terms of ISA 330, which may therefore help the group engagement team in better considering all aspects of where such risks may exist in a group audit, and in how those risks should be responded to, including at the component level.
 - (b) Clarifying or adding to the requirements or application material to emphasize that significant risks identified by component auditors for a specific component should also be considered at the group level by the group engagement team, to determine whether those risks may apply more broadly to some, or all, of the other components (i.e., where the component auditors at other components may not necessarily have identified the same significant risk, but the facts and circumstances would appear to be the same or similar) or for the group overall.
 - (c) Providing further clarification about how significant risks that are pervasive to the group (and therefore exist at all components) impact whether a component is to be considered significant.
 - (d) Developing additional application material to further clarify the meaning of the phrase “of financial significance to the group,” as this may also help address some of the challenges in identifying significant components.

QUESTIONS

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

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

- 254** There is confusion and significant variation in practice relating to the auditor's understanding of the concepts of component materiality and component performance materiality, and their purpose, as well as the manner in which they are determined. For example, practical challenges arise where the component is a non-controlled entity (e.g., may be accounted for using the equity method of accounting) and the entity is larger than the investor entity, such that the materiality and performance materiality for a standalone audit of that component would be larger than group materiality and group performance materiality. It has been noted that ISA 600 does not contain any guidance to address this situation.
- 255** It has also been noted by some stakeholders that, generally, the concept of aggregation risk that underpins the requirements and application material in ISA 600¹⁶¹ is not well-understood. Regulators and audit oversight bodies have noted instances where component materiality has been established at levels equivalent to, or only marginally below, group materiality. Additionally, situations have been identified where the clearly trivial threshold at components exceeds that established at the group level.

References to Existing Requirements and Application Material

- 256** ISA 600 requires the group engagement team to determine:
- Materiality for the group financial statements as a whole when establishing the overall group audit strategy.
 - As necessary in the specific circumstances of the group, lower levels of materiality for classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements as a whole.
 - Component materiality for those components where component auditors will perform an audit or review for purposes of the group audit (and which is required to be less than group component materiality).
 - The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements.¹⁶²
- 257** In addition, where the component auditors will perform an audit for the purpose of the group audit, the group engagement team is required to evaluate the appropriateness of performance materiality determined at the component level (which may be accomplished by the group engagement team either establishing component performance materiality, or evaluating component performance materiality determined by the component auditor).¹⁶³
- 258** If a component has been, or will be, audited on a standalone basis (e.g., for statutory or regulatory purposes) and the group engagement team decides to use that audit to provide audit evidence for the group audit, the group engagement team is required to determine whether the materiality used in the audit of the component financial statements as a whole, and the related performance materiality for the component, comply with the requirements of ISA 600.¹⁶⁴
- 259** ISA 600 requires that component materiality be set at a level lower than materiality for the financial statements as a whole.¹⁶⁵

¹⁶¹ The aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated.

¹⁶² ISA 600, paragraphs 21 and A42–A45

¹⁶³ ISA 600, paragraphs 22 and A46

¹⁶⁴ ISA 600, paragraph 23

¹⁶⁵ ISA 600, paragraphs 21(c) and A43

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260 Many of the issues related to component materiality are intrinsically linked to the requirements and guidance in ISA 320,¹⁶⁶ and therefore cannot be narrowly addressed in the context of a project that is addressing ISA 600 more broadly. In our recently completed Disclosures project, we have acknowledged that work currently being undertaken by the International Accounting Standards Board (IASB) may give rise to further implications to the ISAs relating to materiality. We will continue to monitor the IASB's developments and, in conjunction with our planned consultation on our *Work Plan for 2017–2018*, will obtain input to inform the determination as to the need for a future project to address materiality more broadly, including a possible review of ISA 320 in its entirety.¹⁶⁷ We will also continue to monitor relevant research on the topic. Therefore, we do not believe that any of our actions as part of the group audits project should prejudice the outcomes of those efforts.

261 We are, however, open to the possibility of developing more topic-specific guidance relating to component materiality and other aspects of materiality relevant to group audits, as well as challenging whether any amendments to the requirements in ISA 600 are necessary. Any actions we take should not infringe on the basic principles in ISA 320, in advance of a possible project involving an overall review of that standard as explained above. Examples of matters we could consider in the context of our group audits project include:

- (a) More guidance about how the concepts of component materiality and component performance materiality in the context of a group audit are expected to be applied, recognizing that all groups and their components are likely subject to unique facts and circumstances, and that such guidance will need to retain the principles-based nature of the existing ISAs.
 - Further consideration of matters that are specifically relevant to component materiality, component performance materiality and component clearly trivial thresholds in the context of group audits, particularly in relation to the concept of aggregation risk, and consideration as to how these concepts might be made more clear and operational. Matters to address may include consideration of whether the requirements in ISA 600 should be revised to indicate that component performance materiality and component clearly trivial thresholds should be less than the corresponding amounts at the group level. Additional guidance could also be provided to further emphasize the requirements and provide additional context.
- (b) How materiality is to be applied in situations when procedures other than audits of financial information of components are being performed (e.g., when performing audits or reviews of one or more account balances, classes of transactions or disclosures, or when performing specified audit procedures in terms of paragraphs 27(b) and (c) of ISA 600 or specified procedures in terms of paragraph 29 of ISA 600).

QUESTIONS

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

¹⁶⁶ ISA 320, *Materiality in Planning and Performing an Audit*

¹⁶⁷ As ISA 320 is revised, changes to ISA 450, *Evaluation of Misstatements Identified during the Audit*, will also likely be required.

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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)

Issues Relating to Audit Procedures Performed on the Component's Financial Information

262 The type of work that is required to be performed on financial information of a component depends on whether or not the component is a significant component. If a component has been identified as significant because of its individual financial significance, the group engagement team or component auditor, on behalf of the group engagement team, performs an audit of a component using component materiality.¹⁶⁸ For a component that is significant because it is likely to include significant risks of material misstatement of the group financial statements, the group engagement team or component auditor, on behalf of the group engagement team, performs an audit of the financial information of the component using component materiality or audit procedures on aspects of the financial information to which the significant risks relate, or performs specified audit procedures relating to the significant risks.¹⁶⁹

263 For components that are not significant, the group engagement team performs analytical procedures at the group level.¹⁷⁰ The group engagement team or component auditor may also perform one or more of the following on selected individual non-significant components:

- (a) An audit of the financial information of the component using component materiality.
- (b) An audit of one or more account balances, classes of transactions or disclosures.
- (c) A review of the financial information of the component using component materiality.
- (d) Specified procedures.¹⁷¹

See also paragraphs 274–279 for further discussion about situations where there are only non-significant components, or a large number of non-significant components.

264 Many facts and circumstances affect how audit work on the financial information of components is planned and performed, including whether the work will be performed by the group engagement team or whether a component auditor will be requested to perform the work. Some examples of scenarios that affect the audit work on the financial information of the components include the following:

- A component auditor is requested to perform an audit of the financial information of a component using component materiality and the only reporting on the component's financial information by the component auditor is to the group engagement team (e.g., through a clearance memorandum or similar communication). In addition to not applying the ISA reporting standards, the component auditor may, pursuant to the instructions of the group engagement team, not address requirements of other ISAs when the related audit procedures are performed centrally for the group as a whole (e.g., the component auditor may not obtain written representations from component management, or may not obtain separate communications from legal counsel when the group engagement team instructs the component auditor not to do so on the basis of having obtained such representations or communications at the group level). This situation applies to significant as well as non-significant components, and would result in the component auditor not applying all ISAs that would be relevant in a financial statement audit.¹⁷²
- Component materiality and component performance materiality for purposes of the group audit will likely be higher than the materiality and performance materiality that are required to be used when a component auditor is also issuing an auditor's report on the component's standalone financial statements. Challenges may therefore arise for the component auditor when planning and performing the work for both purposes, especially when the timing is not aligned (i.e., work performed to support the group audit is often required to be completed sooner to support earlier group reporting deadlines).

Many facts and circumstances affect audit work on financial information of components, including the significance of the component and whether the work will be performed by the group engagement team or by component auditors.

¹⁶⁸ ISA 600, paragraph 26

¹⁶⁹ ISA 600, paragraph 27

¹⁷⁰ ISA 600, paragraph 28

¹⁷¹ ISA 600, paragraph 29

¹⁷² Paragraph 18 of ISA 200 requires that the auditor comply with all ISAs relevant to the audit.

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265 Certain audit procedures may be performed centrally by the group engagement team for purposes of the group audit. Consequently, it may not be necessary for the component auditor to perform further audit procedures on the related financial information of the component. For example, the identification and assessment of risks of material misstatement, and planning and performance of audit procedures, related to litigation and claims might be performed by the group engagement team on a group-wide basis because they are managed centrally by the entity, even though the component financial information may include related accounts and disclosures.

266 Similarly, the transactions related to some accounts and disclosures may be processed and accounted for in a SSC and the related audit work might be performed by the group engagement team or another auditor. ISA 600 focuses on the responsibilities of the group engagement team rather than the responsibilities of the component auditors. Component auditors may also have separate responsibilities relating to standalone reporting requirements in their own jurisdictions, at the component level, and may plan to use the work done for standalone reporting for the purposes of the group audit engagement. The possible need for development of separate requirements and related application material dealing with responsibilities of the component auditor is discussed in paragraph 199.

Issues

267 Questions have arisen with respect to the nature, timing and extent of procedures being performed on the component's financial information for group audit purposes. As discussed in the group audits introductory section (paragraphs 191–203), it has been observed that scoping of the audit based on the identification of components may not always result in a top-down approach to the assessment of the risks of material misstatement and the responses to those risks. Another possible consequence of scoping the audit based on the identification of components is that the work performed on the financial information may not always be appropriate or sufficient for the purposes of the group financial statements.

268 Questions have also arisen as to the meaning of “an audit of financial information of the component using component materiality.”¹⁷³ In particular, questions have been raised as to whether this means (and therefore requires) applying all relevant ISAs, or whether it means only applying those ISAs or those requirements in specific ISAs as instructed by the group engagement team, or that the component auditor has determined are appropriate given the work which they have been asked by the group engagement team to perform. Questions have also arisen as to whether “specified audit procedures” and “audit procedures” referred to in paragraphs 27 and 29 of ISA 600, respectively have the same or a different meaning. Questions have also arisen as to how these procedures relate to the procedures that might be performed as or as part of an agreed-upon procedures engagement performed in accordance with ISRS 4400.¹⁷⁴

269 Further challenges have been noted, in particular by practitioners, in instances where some balances are audited in the aggregate or centrally (e.g., when the related processing and accounting is performed at the group-level or at a SSC).¹⁷⁵ The work performed on group-level balances or at a SSC may be important to a component auditor's conclusions when an auditor's report on the separate financial statements of the component is issued (e.g., for statutory or other purposes). In such instances, there is a need for relevant information to be communicated to the component auditor by the group engagement team (or by the component auditor or other auditor who has performed the work).

¹⁷³ The auditor shall comply with all ISAs relevant to the audit. An ISA is relevant to the audit when the ISA is in effect and the circumstances addressed by the ISA exist (ISA 200, paragraph 18).

¹⁷⁴ International Standard on Related Services™ (ISRS™) 4400, *Engagements to Perform Agreed-Up On Procedures Regarding Financial Information*

¹⁷⁵ Possible actions to address issues in relation to SSC are discussed in paragraphs 194 and 244(d). These could also apply when the SSC is not part of the group.

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Questions have also arisen about the requirement to perform analytical procedures at the group level in respect of components that are not significant components. In many cases, the financial information of non-significant components may be aggregated by management with the information relating to significant components. While ISA 600 does not require that these analytical procedures are substantive analytical procedures, questions arise as to how to plan and perform them and how to use the results in supporting the conclusion that sufficient appropriate audit evidence has been obtained.

References to Existing Requirements and Application Material

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ISA 600 includes requirements and guidance for determining the type of work to be performed on significant and non-significant components.¹⁷⁶ However, ISA 600 does not deal explicitly with some of the practical challenges set out above.

Possible Actions to Address the Issues

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In discussing the responses to address the issues, we identified the following possible actions:

- (a) Revisiting the requirements for the types of work required for significant and non-significant components, and challenging whether the outcome of applying them results in the work effort on financial information of components being commensurate with the risks of material misstatements in the components and supports the ability of the group engagement team to reach a conclusion that sufficient appropriate audit evidence has been obtained. Such a review of the requirements may include challenging whether the requirement to perform an audit of the financial information of significant components using component materiality is appropriate in all cases, or whether it should be made more flexible. For example, even in significant components, there may be risks of misstatement that may not be relevant to the group financial statements; however, performing an audit of the component's financial information using component materiality may not provide an opportunity to eliminate such accounts from the scope of the audit work at the component.
- (b) Alternatively, or in addition, the following may also be appropriate:
 - (i) Providing application material to clarify that the manner in which the requirement to perform an "audit of financial information of the component using component materiality" is applied may vary depending on the specific circumstances. For example, it could be clarified that an audit of the financial information of a component performed solely for the purposes of the group audit, and where the only reporting by the component auditor is to the group engagement team, may not necessarily mean that the component auditor is expected to apply *all* requirements in *all* relevant ISAs in *all* circumstances. Rather, the component auditor would be expected to follow the group engagement team's instructions and communicate clearly as to the scope of the audit performed (that might, for example, include indicating that some account balances were not tested or audit procedures were not performed).
 - (ii) Revisiting and providing further clarification as to what the various terms mean in the context of ISA 600. Attention could also be focused on emphasizing the need for clear instructions to the component auditor from the group engagement team, and for a mutual understanding between the component auditor and group engagement team about what is expected of the component auditor.
 - (iii) More clearly distinguishing between the types of procedures that could be performed and in which circumstances they might be appropriate (e.g., through providing examples of "specified audit procedures" or "specified procedures" in specific circumstances, and distinguishing them from "an audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement").

We may challenge whether the existing requirements for the work to be performed at the component level should be more flexible to provide for more judgment in determining how to address the risks of material misstatement at the group level in the most effective manner.

¹⁷⁶ ISA 600, paragraphs 26–31 and A47–A53

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- (iv) Clarifying how the procedures referred to in (iii) above can be distinguished from agreed-upon procedures that might be performed as part of an agreed-upon procedures engagement performed in accordance with ISRS 4400.
- (v) Clarifying the expected work effort related to analytical procedures at the group level for components that are not identified as significant, including providing additional application material as to how to plan and perform such procedures, and how to use the results in supporting conclusions that risks of material misstatement related to the group financial statements have been addressed.
- (vi) Clarifying the distinction between work performed for the purposes of the group audit and work performed to support, for example, a standalone auditor's report at the component level. Application material could also be provided on relevant considerations for the component auditor in different circumstances.

These changes may help clarify the work to be performed on the components, including for significant and non-significant components.

273 Clarification in the requirements, or additional application material, about the implications in situations where audit work is performed on balances in the aggregate, or processed centrally, would also help clarify the procedures to be performed at the components (including in situations when the work is supporting standalone component auditor's reports in addition to the report on the group financial statements). For example, for situations where audit work on goodwill impairment has been performed centrally, application material could be provided for component auditors about their considerations relating to goodwill amounts that have been allocated to the component (including any charges for goodwill impairment) and the necessary procedures (if any) at the component level.

Issues Relating to Non-Significant Components

274 In responding to assessed risks of material misstatement, ISA 600 requires the group engagement team to determine the type of work to be performed on the financial information of components. In setting forth requirements for the necessary work effort, the standard distinguishes between components that are significant¹⁷⁷ and those that are not significant (i.e., "non-significant").¹⁷⁸

Issues

275 ISA 600 does not specifically require that, in making the determination as to what work is necessary for the group as a whole, the group engagement team should consider whether risks of material misstatement remain that are not addressed by work performed on significant components, selected non-significant components, and through work performed at the group level (including auditing of accounts at the group level, procedures to evaluate and test group-wide controls, and the consolidation process). Determining an appropriate approach to scoping a group audit to obtain sufficient appropriate audit evidence is particularly challenging when there are a large number of components, none of which are significant individually, but that in the aggregate represent one or more risks of material misstatement to the group financial statements.

276 Regulators and audit oversight bodies have expressed concerns that in some cases it is not clear that auditors have performed a robust assessment as to whether the risks of material misstatement to the group financial statements related to "residual balances" (i.e., those pertaining to non-significant components that are not otherwise selected for testing) are adequately addressed by the rest of the work performed on the group audit, and therefore have challenged whether the work done on such residual balances is adequate. Questions have also been asked as to whether and, if so, how a review of a component's financial information using component materiality determined by the group engagement team provides audit evidence.¹⁷⁹

¹⁷⁷ ISA 600, paragraphs 26–27

¹⁷⁸ ISA 600, paragraphs 28–29

¹⁷⁹ ISA 600, paragraph 29

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 References to Existing Requirements and Application Material
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277 ISA 600 sets out requirements and application material for procedures that may be relevant for group engagement teams or component auditors to perform in respect to non-significant components.¹⁸⁰ In addition to analytical procedures performed at the group level, procedures may include selecting non-significant components and performing:

- (a) Audits of financial information or of select account balances.
- (b) Reviews of financial information.
- (c) Specified procedures.

The application material includes factors to consider when selecting components and indicates that the selection of components is often varied on a cyclical basis.¹⁸¹

278 Paragraph 29 of ISA 600 requires consideration of additional work if the group engagement team does not consider that sufficient appropriate audit evidence will be obtained without performing work at non-significant components.

Possible Actions to Address the Issues

279 In discussing the responses to address the issues, we identified the following possible actions:

- (a) Strengthening the requirements (with related application material) to address the group engagement team's considerations about the work to be performed on non-significant components, in addition to the work to be performed on significant components.
- (b) Providing further guidance on how the group engagement team should determine which non-significant components would require procedures and how to determine when a sufficient number of components have been selected for the performance of such procedures, notwithstanding that paragraph A53 of ISA 600 addresses, albeit to a limited degree, the situation where a group may be comprised of components that are non-significant components.
- (c) Challenging the role of reviews of component's financial information, including whether they provide appropriate audit evidence. In addition, as discussed above, we could clarify whether there is a difference between the "specified audit procedures" described in paragraph 27(c) of ISA 600 and the "specified procedures" referred to in paragraph 29 of ISA 600.

See also possible actions described in paragraphs 272–273 that might result in a more comprehensive revision to the requirements of ISA 600 relating to the type of work to be performed on the financial information of components.

Issues Relating to the Group Engagement Team's Involvement in the Consolidation Process

280 The consolidation process is a necessary element of the financial reporting process for an entity for which group financial statements are prepared. Paragraph 10 of ISA 600 notes that the "consolidation process" includes "the recognition, measurement, presentation and disclosure of the financial information of components in the group financial statements by way of consolidation, proportionate consolidation, or the equity or cost methods of accounting."

281 Group structures may also necessitate consolidation processes at levels below those of the overall group (i.e., sub-consolidations). As part of obtaining its understanding of the entity, the group engagement team would need to determine whether consolidations of financial information take place at the sub-consolidation level, and the appropriate level of involvement by the group engagement team in such sub-consolidations. Many factors may affect the appropriate level of involvement of the group engagement team in sub-consolidations, including with respect to understanding the controls over the consolidation process at the sub-consolidation level(s). These factors may also affect the group engagement team's assessed risks of material misstatement (see discussion in paragraphs 243–253 about identifying risks of material misstatement in a group audit) in the consolidation process.

¹⁸⁰ ISA 600, paragraphs 28–29

¹⁸¹ ISA 600, paragraph A51

Issues

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- 282** We note that the reference in the description of the consolidation process to including the financial information of components in the group financial statements using the cost method of accounting is a source of confusion, as it appears to imply the investments accounted for using the cost method of accounting would or could be considered components. Questions have therefore been raised with respect to whether investments that are carried at cost or measured at fair value meet the definition of components in ISA 600, and about the applicability of ISA 600 to audits of financial statements that include investments of this nature, for example, as would likely be the case in “fund of funds” structures. Some have the view that investments that are carried at cost or at fair value were generally not intended to be encompassed by the definition of a component, and also that financial statements including these types investments would not be considered group financial statements.
- 283** Notwithstanding that the requirements for the group engagement team’s involvement in the consolidation process are robust, ISA 600 does not deal with the expected involvement by the group engagement team in any sub-consolidation processes. It has been noted that various issues could arise when sub-consolidations are audited by component auditors, and the group engagement team is not appropriately involved, including because the component auditors may not have the full context of the group-wide risks to effectively audit the sub-consolidations.
- 284** Other issues relating to sub-consolidations include:
- Insufficient information for the group engagement team to understand the consolidation entries processed in the sub-consolidation, some of which may be material to the group.
 - Failure by the component auditor to appropriately consider the accounting for or processing of group-wide journal entries necessary for the sub-consolidation process (e.g., as a result of differing accounting policies used by the components and at the consolidated level).
 - Ineffective controls over the consolidation process that are not properly considered by the group engagement team or the component auditors.
- 285** In addition, it has been suggested that additional perspectives should be sought about whether more application material could be included in the standard about consideration of internal control relevant to the audit and the entity’s financial reporting process used to prepare the consolidated financial statements through making a more direct link to relevant requirements and application material in ISA 315 (Revised). Such linkage might also highlight relevant disclosures that might be based on information that comes from outside the general ledger (see paragraph 304).

Notwithstanding that the requirements for the group engagement team’s involvement in the consolidation process are robust, ISA 600 does not deal with the expected involvement in any sub-consolidation processes.

References to Existing Requirements and Application Material

- 286** As part of the required understanding of the group, its components and their environments, the group engagement team is required to obtain an understanding of the consolidation process,¹⁸² with an explicit direction that this includes an understanding of the instructions issued by group management to components. The group engagement team or component auditor, at the request of the group engagement team, is required to test the operating effectiveness of group-wide controls if the nature, timing and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively, or if substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. The group engagement team is required to design and perform further audit procedures on the consolidation process to respond to material assessed risks of misstatement of the group financial statements arising from the consolidation process.¹⁸³

¹⁸² ISA 600, paragraph 17(b)

¹⁸³ ISA 600, paragraphs 32–33

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ISA 600 also requires the group engagement team to:

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- (a) Evaluate whether all components have been included in the group financial statements.¹⁸⁴
- (b) Evaluate the appropriateness, completeness and accuracy of the consolidation adjustments and reclassifications and whether any fraud risk factors or indicators of management bias exist.¹⁸⁵
- (c) Evaluate whether appropriate consolidation adjustments have been made to the components for any differences in accounting policies.¹⁸⁶
- (d) Determine that the component information identified in the component auditor's communications has been consolidated.¹⁸⁷
- (e) Evaluate whether appropriate adjustments have been made for the financial information for any components that have different financial reporting periods.¹⁸⁸

Possible Actions to Address the Issues

288

In response to addressing the issues, we identified the following possible actions:

- In relation to investments carried at cost or at fair value, revisiting the interaction between the definition of component and the description of the consolidation process in ISA 600. This could include:
 - Considering whether to remove the reference to the cost method of accounting in the description of the consolidation process.
 - Clarifying that financial statements that only include investments accounted for at fair value or using the cost method of accounting are not considered group financial statements for the purposes of ISA 600.
- Revisiting the requirements in ISA 600 to determine whether the group engagement team's responsibilities in relation to sub-consolidations need to be clarified or enhanced. This could include recognition that component auditors would likely not have the "full picture" of the group that the group engagement team has, and therefore may not be in a position to properly evaluate the completeness and accuracy of all consolidation adjustments at the sub-consolidation level for the group audit. In making revisions, it could be emphasized that determining the appropriateness of the group engagement team's involvement would be dependent on the circumstances and structure of the group, and involve appropriate application of professional skepticism.
- New application material could be developed in the context of the group engagement team's responsibilities for the consolidation process (and possible sub-consolidations), to better link, or build on, the requirements and application material in ISA 220 in respect of the engagement partner's responsibilities for the direction, supervision, performance and review of the audit engagement.
- ISA 600 could be enhanced by more explicitly linking to the relevant requirements and application material in ISA 315 (Revised) (which requires the auditor to obtain an understanding of internal control relevant to the audit and the financial reporting process used to prepare the entity's financial statements),¹⁸⁹ and adding more application material to ISA 600 to explain how this might apply in the context of a group audit, specifically when sub-consolidations exist.
- Elevating in status to application material or requirements some aspects of the examples of matters to consider when understanding the consolidation process currently contained in Appendix 2 of ISA 600.

¹⁸⁴ ISA 600, paragraph 33

¹⁸⁵ ISA 600, paragraph 34

¹⁸⁶ ISA 600, paragraph 35

¹⁸⁷ ISA 600, paragraph 36

¹⁸⁸ ISA 600, paragraph 37

¹⁸⁹ ISA 315 (Revised), paragraph 18

Issues Relating to Subsequent Event Procedures

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- 289** Many financial reporting frameworks specifically refer to subsequent events. The auditor's subsequent event procedures address the identification of events that occur after the date of the financial statements, and that might require adjustment to, or disclosure in, the group financial statements.

Issue

- 290** Some regulators and audit oversight bodies have noted instances where the group engagement team has not adequately evaluated the work of component auditors in relation to subsequent events, or that the period covered by such work is inadequate.

References to Existing Requirements and Application Material

- 291** When audits of the financial information of components are performed, the group engagement team, or the component auditors, are required to perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements, and that might require adjustment to or disclosure in the group financial statements. When component auditors perform work other than audits of the financial information of components, the group engagement team is required to request that the component auditors notify the group engagement team if they become aware of subsequent events that might require adjustment or disclosure in the group financial statements.¹⁹⁰

Possible Actions to Address the Issues

- 292** In discussing the responses to address the issues, we identified the following possible actions:
- Clarifying the existing requirements or providing additional application material in ISA 600 to emphasize the importance of the group engagement team providing clear instructions to the component auditor about subsequent event procedures, including the period that they should cover, and the group engagement team's evaluation of the component auditors' procedures.

QUESTIONS

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) GA7

REVIEW AND EVALUATION OF THE WORK OF COMPONENT AUDITORS BY THE GROUP ENGAGEMENT TEAM

Issues Relating to Evaluating the Communications from the Component Auditors and the Adequacy of their Work

- 293** ISA 600 allows flexibility as to the necessary level of involvement in the work of the component auditors by the group engagement team, including as it relates to the review of component auditors' audit documentation. When reviewing and evaluating the work performed by the component auditor, the group engagement team's considerations would include whether the audit evidence obtained is sufficient and appropriate in the circumstances and that it supports the group engagement team's conclusions in accordance with the ISAs.
- 294** The group engagement team determines how to evaluate the component auditor's communications and the adequacy of their work based on the specific circumstances of the engagement, and with respect to each component and its respective component auditors.¹⁹¹

¹⁹⁰ ISA 600, paragraphs 38–39

¹⁹¹ ISA 600, paragraphs 42(a) and (b), 43 and A61

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- 295** As discussed in paragraphs 235–242, the level and manner of the group engagement team's involvement in the work of the component auditors will vary based on the circumstances of the group engagement. The nature and extent of documentation in the group audit file relating to the evaluation by the group engagement team of the component auditor's findings also varies significantly. For example, the group engagement team's procedures may range from including documentation of a review by the group engagement team of selected working papers prepared by the component auditors to including copies of the component auditors' working papers in the group audit file.

Issues

- 296** Concerns have been raised by regulators and audit oversight bodies that the flexibility in ISA 600 regarding the nature, timing and extent of necessary involvement in the work of the component auditors, including the review of component auditors' audit documentation, has led to situations where group engagement teams are not able to demonstrate that an appropriate evaluation of the component auditors' findings has been undertaken. In this regard:
- It has been noted that the requirement in paragraph 42(b) of ISA 600 relating to the review of the relevant parts of a component auditor's audit documentation, and the related application material in paragraph A61, are not sufficiently detailed to provide appropriate direction to group engagement teams (i.e., as to when it would be appropriate or expected that a group engagement team would make the determination that it would be necessary to review component auditor's audit documentation).
 - These issues may sometimes arise because the review of the component auditors' documentation (including working papers and conclusions) by the group engagement team is not sufficiently documented in the group audit documentation. As a result, issues arise related to the group engagement team being able to adequately support the significant judgments made in relation to this review.

The level and manner of the group engagement team's involvement in the work of component auditors will vary based on circumstances, but we have heard that we should challenge whether the requirements in ISA 600 are sufficiently robust.

References to Existing Requirements and Application Material

- 297** ISA 600 requires the group engagement team to evaluate the component auditor's communication of the matters referred to in paragraph 41, and in particular discuss significant matters arising from that evaluation, as appropriate, and determine whether it is necessary to review other relevant parts of the component auditor's audit documentation.¹⁹²
- 298** In addition, as part of the required evaluation of the sufficiency and appropriateness of the audit evidence obtained, the application material notes that the component auditor's audit documentation that may be relevant to the group audit may vary depending on the circumstances.¹⁹³

Possible Actions to Address the Issues

- 299** In discussing the responses to address the issues, we identified the following possible actions:
- Strengthening the requirement in paragraph 42(b) of ISA 600, and the related application material, to clarify the necessary work effort of the group engagement team in relation to reviewing the component auditor's working papers. Such clarification would likely, therefore, result in better demonstration of the judgments made and the application of professional skepticism by the group engagement team as to the appropriateness of their involvement. For example, to encourage the group engagement team to review the work of the component auditor to understand the extent and quality of the procedures performed by the component auditors (including an EQC review undertaken), the requirements and related application material could be revised to provide more clarity on

¹⁹² ISA 600, paragraphs 42 (a) and (b)

¹⁹³ ISA 600, paragraph A61

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when reviews of component auditor's audit documentation by the group engagement team would be appropriate, as well as the procedures that the group engagement team would perform as part of the review. However, care will be needed to ensure that, all other things being equal, the extent of the review required or expected by the group engagement team does not exceed that which would be undertaken in a non-group audit situation. In addition, further consideration will be given in the quality control project to the involvement and review by the EQC reviewer (see further discussion in paragraph 143). At the same time, the fact that the work of the component auditor may have been reviewed by the engagement partner of the component auditor should also be factored into the determination about the nature and extent of this review.

- Strengthening the documentation requirements regarding the group engagement team's evaluation of the component auditors' communication, including the nature of any review of documentation that was performed by the group engagement team, specifically linking to the requirements in ISA 230.¹⁹⁴ These matters need to be considered in light of the fact that the work of the component auditors is likely already reviewed by the engagement partner responsible for the work performed on the component, and that, all other things being equal, this review should not exceed the nature and extent of review by an engagement partner of another partner's work in a non-group situation.

Issues Relating to the Evaluation of the Work of the Component Auditors on the Group Audit Engagement and Whether Sufficient Appropriate Audit Evidence has been Obtained

300 In evaluating whether sufficient appropriate evidence has been obtained, the group engagement team considers the work done on the consolidation process and the work done by, and the findings of, the component auditors that have been communicated to the group engagement team (see also paragraphs 280–288 and 218–225 regarding issues and possible actions regarding the consolidation process and communications between the group engagement team and component auditors).

Issues

301 In some cases, the audit documentation may not explicitly demonstrate the group engagement team's judgments, as appropriate, in relation to the evaluation of the findings of the component auditors. For example, some regulators and audit oversight bodies have noted instances where there is insufficient consideration of the effect on the group audit of the component auditor's findings, including the evaluation of whether sufficient appropriate audit evidence has been obtained.

References to Existing Requirements and Application Material

302 The auditor is required to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level, thereby enabling reasonable conclusions to be drawn on which to base the auditor's opinion.¹⁹⁵ The group engagement team is required to evaluate whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion as a result of the audit procedures performed on the consolidation process, and the work performed by the group engagement team and the component auditors on the financial information of the components.¹⁹⁶ The group engagement team's evaluation of the adequacy of the component auditor's work will therefore support the conclusion as to whether sufficient appropriate audit evidence to support the group audit opinion has been obtained.

¹⁹⁴ ISA 230, paragraph 8

¹⁹⁵ ISA 200, paragraph 17

¹⁹⁶ ISA 600, paragraph 44

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Possible Actions to Address the Issues

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303

In discussing the responses to address the issues, we identified the following possible actions:

- Strengthening the communication requirements between the group engagement team and the component auditors and emphasizing the importance of ongoing two-way dialogue (as discussed in paragraph 224(a)). This will support the group engagement team in obtaining the necessary information to evaluate the findings of the component auditor. For example, consultations outside of the component engagement team may be indicative of areas of interest to the group engagement team (e.g., such consultations may indicate a significant risk not previously identified) and, when not communicated, may not be properly evaluated by the group engagement team.
- Strengthening the documentation requirements for the group engagement team, emphasizing the importance of appropriately documenting significant judgments relating to the findings of the component auditors (e.g., requiring the group engagement team to document that the consideration as to whether a component auditor finding for one component gives rise to increased risk where similar circumstances exist in other components).

QUESTIONS

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

OTHER ISSUES RELATING TO GROUP AUDITS

The Impact of New and Revised Auditing Standards

Disclosures

304

In our recently completed disclosures project, we identified the need for the ISAs to specifically address the group engagement team's considerations of the impact of component financial statement information on the disclosures in the group financial statements (i.e., that ISA 600 needed to be strengthened in this regard). As we develop our group audits project proposal, we will consider the need to focus more explicitly on relevant considerations about group financial statement disclosures in the requirements or the application material of ISA 600, including giving consideration to the relevance of financial information of components.

Identifying Key Audit Matters in a Group Audit Engagement

305

As we develop our group audits project proposal, we will consider the need for any revised requirements or additional application material relating to communication of key audit matters by the group engagement team in the auditor's report on the group financial statements, where applicable. For example, it may be appropriate for ISA 600 to include additional application material to assist group engagement teams and component auditors in having effective communications so as to ultimately support the identification, where applicable, by the group engagement team of those matters that might be considered and ultimately determined to be key audit matters in the context of the group audit.

QUESTION

The Impact of New and Revised Auditing Standards GA9

QUESTIONS

Overall Questions for Group Audits GA10–GA13

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Questions for the ITC

The following questions for respondents relate to the matters set out in this ITC, and also appear following the relevant discussion in this document. We welcome responses to any or all of these questions. Responses will be most helpful when they clearly indicate to which question the response relates and articulate respondents' rationale for their views. A Word template is available to facilitate this.

Question numbers are coded to the consultation topics as follows:

- **G = General Question**
- **PS = Professional Skepticism**
- **QC = Quality Control**
- **GA = Group Audits**

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?
 - (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.
 - (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.
- 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?
- 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.

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?
- 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?
- 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?
- 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?
- 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?

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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.

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

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?
 - (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) 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).

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.
- (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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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.

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?
 - (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?

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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.
- (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.

QC7. *Monitoring and Remediation*

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

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?

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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?
 - (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.

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.

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?
- QC12. Are there any other specific actions that others could take in relation to quality control? If yes, please provide details.
- 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.
- 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.

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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.

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?

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

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?

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?

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- (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.

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.
- (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?

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.

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.

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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.
- (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 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?

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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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:

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?

GA11. Are there any other specific actions that others could take in relation to group audits? If yes, please provide details.

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.

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.

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