

# IAASB CAG PAPER



International Federation of Accountants

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## Agenda Item

# H

**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Paris

**Meeting Date:** May 11-12, 2006

### **Report Back—Proposed ISA 600 (Revised and Redrafted), The Audit of Group Financial Statements**

#### **Objectives of Agenda Item**

1. To provide a brief report back on the November 30-December 1, 2005 proposals of Representatives on the re-exposure draft of the proposed revised ISA 600, “The Audit of Group Financial Statements,” (the “March 2006 Exposure Draft”) and on significant changes processed before the IAASB approved the re-exposure draft for issue in March 2006.
2. To review the application of the clarity drafting conventions to the proposed revised ISA. Two questions are asked of CAG member organizations – see page 5 of this Agenda Item.

#### **November 30-December 1, 2005 CAG Proposals**

Below is an extract from the minutes of the November 30-December 1, 2005 CAG meeting minutes<sup>1</sup> and an indication of how the IAASB task force or the IAASB responded to the Representatives’ comments.

Representatives’ comments	IAASB task force/IAASB response
Ms. Sucher was of the view that the summary of significant comments did not clearly explain the reasons for the task force’s recommendations.	The reasons for the task force’s recommendations were further explained during the March 2006 IAASB meeting and are described in the Explanatory Memorandum (which forms part of the March 2006 Exposure Draft – <b>refer to Agenda Item H.1.</b> ).
Some Representatives were of the view that it was not clear whether the term “group auditor” refers to an individual and/or the audit firm, or who would be regarded as members of the engagement team and as other auditors.	These concerns were addressed by revising the definition of “group auditor” and “other auditor or another auditor,” as well as by introducing a new term “members of the engagement team under the direct supervision of the group engagement partner.” <b>Refer to Agenda Item H.1: paragraphs 7(d), 7(h) and 7(i) of proposed ISA 600 (Revised and Redrafted), and paragraphs 8-14 of the Explanatory</b>

<sup>1</sup> The minutes will be approved at the May 11-12, 2006 IAASB CAG meeting.

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Representatives' comments	IAASB task force/IAASB response
	<b>Memorandum.</b>
Mr. Roussey was concerned that the proposed ISA uses accounting terms differently from their use in the International Financial Reporting Standards (IFRSs). For example, the term “consolidation” in the proposed ISA includes accounting for associated companies by the equity method. This is not the case in IFRSs.	References to “consolidation” have been changed to “consolidation process.” <b>Refer to Agenda Item H.1: paragraph 8.</b> Conforming changes have been processed.
Mr. Rabine noted that the term “commonality” used in the context of the group auditor’s understanding of other auditors, is not a commonly-used term and may be difficult to translate – “equivalence” might be better.	The term “commonality” has been replaced with the term “consistency or similarity.” <b>Refer to Agenda Item H.1: paragraph A14.</b>
Referring to the identification of significant components based on their individual financial significance to the group, Mr. Popham suggested that the example in the application material, which contained what was in his view a rather low percentage applied to a chosen benchmark, be deleted.	<b>Refer to Agenda Item H.1: paragraphs 16-18 of the Explanatory Memorandum.</b>  The IAASB agreed that the example of the percentage to be applied to a chosen benchmark to identify a component that is of individual financial significance in proposed ISA 600 (Revised and Redrafted) should be presented in a way that is similar to the presentation of the examples of percentages to be applied to chosen benchmarks in proposed ISA 320, “Materiality in Planning and Performing an Audit.” The task force also reconsidered its recommendation to change the percentage from 20% to 10%, and concluded that 15% is a more appropriate example. <b>Refer to Agenda Item H.1: paragraph A5.</b>
Some Representatives were of the view that the requirements and guidance on access to information did not provide sufficient guidance on the “other means” by which the group auditor could obtain the necessary audit evidence. However, they did agree that, should the group auditor not be able to obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level, he or she should not accept/continue the engagement or consider the effect	The requirements in <b>paragraphs 9-13 of proposed ISA 600 (Revised and Redrafted) (refer to Agenda Item H.1)</b> have been redrafted to focus on whether the group auditor will be able to obtain sufficient appropriate audit evidence on the consolidation process and the financial information of the components to reduce audit risk for the group financial statements to an acceptably low level. If the group engagement partner concludes that it will not

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<p>on the auditor's report, as required by the proposed ISA.</p>	<p>be possible to obtain such audit evidence, and the possible effect of this inability will result in a disclaimer of opinion on the group financial statements, the group engagement partner should not accept the engagement. <b>Paragraphs A7-A10</b> address matters relating to access to information. <b>Paragraph A8</b> provides an example of how the group auditor may obtain sufficient appropriate audit evidence in relation to the financial information of a component (which is not a significant component), where his/her access is restricted by circumstances. The guidance recognizes that, where access is restricted by group management, it is unlikely that the group auditor will be able to obtain sufficient appropriate audit evidence.</p> <p>Also refer to <b>Agenda Item H.1: paragraphs 15-22 of the Explanatory Memorandum</b>.</p>
<p>Some Representatives suggested that the proposed ISA require the other auditor to provide the group auditor with access to relevant parts of his or her audit documentation if not prohibited by law or regulation.</p>	<p><b>Paragraph 14(d)</b> has been added to <b>proposed ISA 600 (Revised and Redrafted) (refer Agenda Item H.1)</b>. As part of determining the group auditor's involvement in the work to be performed by the other auditors, the group auditor should obtain an understanding of whether the other auditor will provide the group auditor with the necessary access to audit documentation. Access to the other auditors' audit documentation is also addressed in <b>paragraphs 49(d), A11</b> and the confirmation letter in <b>Appendix 4</b>.</p>
<p>Mr. Roussey suggested that the proposed ISA provide for rotation of the audit of components that are not significant.</p>	<p>Although the concept is described in ISA 330, "The Auditor's Procedures in Response to Assessed Risks," the term "rotation" is not used. The task force followed a similar approach in revising proposed ISA 600 (Revised and Redrafted). <b>Refer to Agenda Item H.1: paragraph A28 of proposed ISA 600 (Revised and Redrafted)</b>.</p>
<p>Mr. Popham asked whether the matters required to be included in the other auditor's memorandum or report of work performed are not too onerous in the case where a statutory audit is performed on the financial</p>	<p>See Communication With Other Auditors under Other Significant Changes Made Prior to Approval of the March 2006 Exposure Draft below.</p>

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statements of a component.	
Mr. Roussey suggested that the guidance be expanded to refer to the use of work performed by internal auditors, or that – at a minimum – a cross reference to ISA 610, “Considering the Work of Internal Audit” be included.	Refer to <b>Agenda Item H.1: paragraph 2 of Appendix 2 of proposed ISA 600 (Revised and Redrafted)</b> .

### Other Significant Changes Made Prior to Approval of the March 2006 Exposure Draft

#### THE EFFECT ON AUDIT RISK OF USING THE WORK OF OTHER AUDITORS

Some IAASB members were of the view that the explanation of the effect on audit risk of using the work of another auditor should not include the list of actions that the group auditor could undertake to be involved in the work of another auditor. It was agreed that this list should be moved to the requirements section. **(Refer to Agenda Item H.1: paragraph 26 of proposed ISA 600 (Revised and Redrafted.)**

#### OBTAINING AN UNDERSTANDING OF THE OTHER AUDITORS

IAASB members raised a number of concerns about the requirement for the group auditor to obtain a confirmation from the other auditor whether his/her firm's quality control system complies with the International Standard on Quality Control (ISQC) 1. It was agreed that this requirement should be deleted, but that the group auditor should be required to obtain an understanding of the other auditor's firm's quality control system, including whether it has implemented ISQC 1. It was also agreed that the application material should explain how the fact that the group auditor and another auditor operate under common quality control policies and procedures affects the group auditor's understanding of that other auditor and the procedures the group auditor performs in relation to that other auditor's work. **(Refer to Agenda Item H.1: paragraphs 14(c) and A14-A15 of proposed ISA 600 (Revised and Redrafted.)**

#### MATERIALITY

The IAASB agreed that the requirements should be revised to clarify that the group auditor should determine the materiality level for the group financial statements as a whole when establishing the overall audit strategy for the group audit. To reduce the risk that the aggregate of detected and undetected misstatements in the group financial statements exceeds the materiality level for the group financial statements as a whole, the group auditor should determine materiality levels for the components that are lower than the materiality level for the group financial statements as a whole. The group auditor or the other auditor should also determine an amount lower than the materiality level for the component for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks at the component level. If the other auditor determines this amount, the group auditor should determine its appropriateness

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before significant work is performed on the financial information of the component. ***(Refer to Agenda Item H.1: paragraphs 18 and 19 of proposed ISA 600 (Revised and Redrafted).)***

### COMMUNICATION WITH OTHER AUDITORS

The task force was asked to consider whether the information to be communicated by the group auditor to the other auditor and by the other auditor to the group auditor applies to all types of work performed by other auditors (at the request of the group auditor) on the components' financial information.

The IAASB debated the information to be included in the other auditor's memorandum or report of work performed. In particular, one IAASB member was concerned about the requirement to describe the work performed by the other auditor, including, where applicable, materiality used to plan and perform the work, a list of significant risks identified at the component level that may result in a misstatement in excess of component materiality, the other auditor's response to such risks, and the results of further audit procedures. In response to this concern, the IAASB agreed that, to the extent not already communicated to the group auditor, the other auditor's memorandum or report of work performed should include a list of significant risks that have been identified in the component, the other auditor's response to such risks, and the results thereof. ***(Refer to Agenda Item H.1: paragraphs 39 and 40 of proposed ISA 600 (Revised and Redrafted).)***

### Proposed Clarity Drafting Conventions

With regard to the application of the proposed clarity drafting conventions, CAG Representatives are asked to consider the following:

- (a) Is the objective to be achieved by the auditor, stated in paragraph 6 of the proposed ISA, appropriate?
- (b) Have the guidelines identified by the IAASB for determining whether a requirement should be specified been applied appropriately and consistently, such that the resulting requirements are at a level that promotes consistency in performance and the use of professional judgment by auditors?<sup>2</sup>

<sup>2</sup> In accordance with the Exposure Draft on "Improving the Clarity of IAASB Standards," the IAASB will determine the requirements of a Standard as follows:

- The requirement is necessary to achieve the objective stated in the Standard;
- The requirement is expected to be applicable in virtually all engagements to which the Standard is relevant; and
- The objective stated in the Standard is unlikely to have been met by the requirements of other Standards.
- In determining the requirements of a Standard, the IAASB will consider whether the requirements are proportionate to the importance of the subject matter of the Standard in relation to the overall objective of the engagement.

These guidelines, which are intended only to assist the IAASB in appropriately and consistently determining requirements, may be refined as further experience is gained.

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The Appendix to the Explanatory Memorandum (*refer to Agenda Item H.1*) “maps” the “should” requirements and present tense sentences in the March 2005 Exposure Draft to the related “shall” requirements and application material in the March 2006 Exposure Draft.

### Material Presented

Agenda Item H.1      March 2006 Exposure Draft of Proposed ISA 600 (Revised and Redrafted), “The Audit of Group Financial Statements” – FOR REFERENCE PURPOSES ONLY