

Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
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Organizaç o Internacional das Comiss es de Valore

October 19, 2005

Mr. Jim Sylph  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, NY 10017

Re: Proposed International Standard on Auditing 600 (Revised), "The Audit of Group Financial Statements"

Dear Mr. Sylph:

IOSCO's Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) appreciates the work of the IAASB that is being directed to revising and improving an international standard for group audits. Audits conducted using multiple auditors and often on a cross-border basis are important to investors and to our members.

Among our members, national jurisdictions have a number of different regulatory practices and experiences with group audits that are reflected in our comments. One point of difference that is cited in the Exposure Draft concerns whether group audits should be conducted only on what has been termed a "sole responsibility" reporting approach or whether both "sole responsibility" and "divided responsibility" reporting approaches should be permitted. We use the term "reporting approaches" in this letter, to highlight that all our members are united in the view that a group auditor has the responsibility to obtain sufficient and appropriate audit evidence to support a group auditor opinion on the total group financial statements, regardless of which approach is used. Where the point of difference arises is not a matter of the group auditor's responsibility for the total group audit, but rather concerns disclosure that the group auditor has accepted another auditor's audit and audit opinion as evidence for a significant component of a group entity.

In our earlier comment letter, we urged that an ISA be developed that would focus on what would need to be done to conduct a high quality group audit regardless of what approach would be used. We quote below a portion of our earlier comments:

*"We believe that the IAASB should make the fundamental assumption that the work to be performed in a group audit should generally be unaffected by whether or not the use of other auditors is mentioned in*

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*some way in an audit report in some jurisdictions. More directly stated, in our opinion the guidance should make it clear that the work required of the group auditor is substantially the same whether the auditor decides to accept sole responsibility or divide responsibility by reference to the work of another auditor.*

*If this assumption is made, the standard can be revised to require substantially the same procedures and the same degree of diligence on the part of the group auditor regardless of any potential reference to the work of another auditor. It will not be necessary for the standard to have separate presentations for sole and divided opinion audits. The ISA for group audits should present a single set of comprehensive guidance for all group audits. Separate commentary with respect to the group auditor's reference to the work of another auditor can then be presented within the body of the standard and will likely require only a few paragraphs of discussion."*

It is unclear to us how this issue has been addressed in the most recent Exposure Draft, as the standard appears to have been written as described above, while the accompanying Explanatory Memorandum mentions "elimination of the divided responsibility option".

***The standard's definition of "group auditor" is still ambiguous.***

The intended definition of group auditor has not been sufficiently clarified in this proposed standard. The changes made in this ED as compared to the previous ED still do not clearly answer the question of whether the term "group auditor" was intended by the IAASB to be only the engagement partner and his or her engagement office team, or was intended to be the *audit firm in the country where the group audit engagement is being led*. The latter definition would include the engagement partner and personnel in the engagement partner's office plus personnel in other offices of that same audit firm in the same country.

Different interpretations of who is the group auditor arise from reading different portions of the ED and could give rise to inconsistent application of auditing procedures. For example, Paragraph 5 (e) as supplemented by footnote 2 on page 10 of the ED makes it sound as if the group auditor may be either the engagement partner or the audit firm. But if the group auditor is the audit firm, the first part of the definition of 5 (k), i.e., "an auditor from the group auditor's firm" makes no sense - if the firm is the group auditor, then related auditor could not also be defined as an auditor elsewhere in the firm.

Because so much of the guidance in this proposed standard is affected by what is defined as the "group auditor", the standard is not understandable without a clear definition of that term and consistent usage throughout the standard. Whether the term group auditor is intended to apply to either the engagement partner or the firm, or is intended to include both whenever used, each statement in the standard in which the term appears should be checked for consistency.

***Responses to Questions in the Explanatory Memorandum***

In regard to the four questions posed in the Explanatory Memorandum, we have the following responses:

- 1. Is the approach to the work of other auditors practical, having regard to the elimination of the divided responsibility option?**

We support an approach that would focus on the objectives, criteria, and audit work that is needed for the conduct of a high-quality group audit, regardless of where the audit work is undertaken, and regardless of the responsibility reporting approach used in the audit.

The majority of members of SC 1 support the use of the sole responsibility approach, whereby the group auditor takes responsibility for all portions of the group audit, including audit work done by other auditors, and makes no mention of the use of other auditors or reliance on their work for portions of the audit as a result of taking that sole responsibility. These members believe that that this approach will provide the right incentives for the auditor to determine that any other auditors used on the audit are suitably qualified and independent and to properly supervise their work.

One member of SC 1 believes that a reporting approach that mentions other auditors is desirable in certain circumstances as this approach discloses to investors the use of, and reliance upon, other auditors for portions of the audit in cases where an audit report was obtained for a component and the group auditor has judged it appropriate and necessary to rely on that auditor's report as the audit evidence for that component. This SC 1 member believes that the divided responsibility report provides transparency to investors about the way that the audit was actually conducted and would not support discontinuance of the approach in the absence of research or other evidence as to how such discontinuance would be beneficial to users.

All our members believe that the group auditor is responsible for the audit of the total group financial statements regardless of reporting approaches, that is, the auditor who leads the engagement (and who signs the audit opinion in countries where an individual signature is required) must be satisfied that sufficient appropriate audit evidence has been obtained to reach a conclusion and render an opinion on the consolidated group financial statements as a whole. We all agree that this obligation should not be reduced because one or more other audit firms participate in part of the audit, whether or not the other auditors are mentioned and identified as having audited a component of the group entity in the group auditor's report.

As part of meeting the objectives of a group audit, the engagement partner leading the audit must have, or obtain, reasonable assurance that he or she is able to rely on the qualifications and independence of other auditors that may participate in the group audit. We acknowledge that quality control matters are discussed in ISA 220 and ISQC 1, but believe that the group audit standard should provide more coverage of the criteria that must be satisfied in order for an engagement partner to be able to rely on another auditor's qualifications and work. The standard should require evaluation of the system(s) of quality control in place on group audits and the degree to which the system or systems can provide adequate assurance to engagement partners, whether the auditors involved are in a large firm, a small firm, or a firm network. The nature of the quality control system supporting a group audit may differ depending upon the nature of the audit firm involved, but quality and what exists to support the engagement partner's ability to rely on the work of other auditors should be specifically addressed in the planning and execution of every group audit.

In the case in which the group auditor is using other auditors in other offices of the same national firm and/or in affiliated firms and there is a firm-wide and network-wide quality control system and common methodology in place, the firm and network's quality control system may be able to provide this assurance and support to engagement partners on a routine and continuous basis. Only in the circumstance where an *effective* quality control system exists and can provide continuous assurance to an engagement partner would it be reasonable for a standard to assert that "the group auditor may rely on the qualifications, independence, and competence of a related auditor in the absence of information

to the contrary." Many of our members are uncomfortable with the ED's present statement regarding greater reliance on a related auditor.

All our members wish to emphasize the importance of an audit firm providing the necessary assurance and support to its engagement partners through the establishment and maintenance of an effective firm-wide quality control system addressing, among other things, auditor qualifications, independence, and competence. Without the existence of such a system, particularly in a firm doing cross-border audits, an engagement partner can be left with insufficient resources to provide reasonable assurance regarding the suitability of other auditors. In this regard, we had considerable discussion regarding the statements in ISQC 1, paragraph 87, that are cited in the ED's paragraph 5 (k) definition of "related auditor". Do we understand correctly that the term "network firm" is not synonymous with or equal to the term "related auditor"? As we read these passages, it would appear that a "related auditor" must be a firm that meets both of the following conditions: one, it is part of a firm network or is otherwise affiliated with the group auditor firm, and two, it must have common quality assurance procedures and policies with the group audit firm including monitoring and reporting that are in compliance with ISQC 1. To support high quality audits, we would add a third condition, that the quality control system must operate effectively, and the audit firm should provide assurance to the engagement partner that the system is effective, in order for the engagement partner to place reliance on it.

We also believe that there should be a greater emphasis on the objective of the requirement for "involvement" in the work that other auditors perform on the financial information, along with additional coverage of alternatives for achieving sufficient involvement when confronted with cross-border obstacles. One suggestion for greater emphasis on the objective would be to state that the group auditor should be involved "to the degree necessary to ensure that the group auditor can place sufficient reliance on the other auditor's evidence".

## **2. Are the revised standards and guidance on accepting or continuing an engagement to audit group financial statements appropriate?**

We believe that the standards are mostly appropriate, and have provided detailed comments elsewhere in this letter where we believe additional improvements are needed.

An essential factor in performing a high quality group audit is that the group auditor must be in a position to evaluate the overall audit risk of misstatement in the consolidated financial statements, and therefore must be familiar with the business of the whole group. The group auditor must be able to identify the totality of the group reporting entity and all components within this entity. The group auditor must be able to identify the financial significance of the individual components and determine those that contain significant risks related to the whole group. We believe that the group auditor should directly perform the work on components that include significant risks related to the whole group or should obtain equivalent information and assurance through supervising and reviewing the work of suitably qualified other auditors as needed to ensure that there is sufficient evidence to support the audit opinion. As part of this, a client requirement to use other auditors should be considered in assessing risk in the engagement and in performing the audit. We believe there should be more emphasis on evaluating a client's stated requirement that other audit firms will audit a particular component of a group entity, as a necessary part of assessing risk in the audit. The group auditor should evaluate the reasons given why a client insists that other auditors must audit a significant component, and judge whether the effectiveness of the other auditors' quality control systems can be readily ensured. Such coverage could be added to paragraph 11 or provided in a separate paragraph.

We also believe that the work on consolidation would need to be performed by the group auditors themselves. We suggest that the Board clarify the wording in paragraph 69 to state “*the group auditor should perform the work on consolidation*”, instead of a “determine the work” approach as seems to be suggested in the proposed ED.

**3. Do the revised standards and guidance on access to information, given various laws of jurisdictions, give rise to an unnecessary foreseeable difficulty?**

We would like to see greater coverage of alternative ways in which a group auditor can obtain sufficient appropriate audit evidence when confronted with cross-border legal and confidentiality obstacles, as noted elsewhere in this letter.

We agree with the Board that restrictions that have a material and pervasive impact on the audit evidence obtained should result in a disclaimer of opinion or resignation from the engagement. However, we believe there are many less extreme obstacles and restrictions that may arise in practice. We encourage the Board to give additional guidance on limitations of lesser degree, and include examples of the kinds of actions that would be needed to overcome restrictions on the auditor’s direct access to information on components over a wide range of circumstances.

We believe it is fundamental that the group auditor must be able to obtain whatever information that he or she judges necessary to constitute “sufficient appropriate audit evidence” from all other auditors participating in the audit. Such information may variously be in the form of detailed worksheets, analyses of risk, summary memos of work done and conclusions, summaries of unadjusted differences, discussions with management and those charged with governance, audit opinions supplied after a full audit of a component and/or other documents or work papers. The group auditor must have the opportunity to meet with all other auditors and discuss their work as needed. The group auditor must be able to review whatever documents that he or she judges are needed to support the conclusions in the audit. The group auditor must also be able to have any discussions directly or through suitably qualified other auditors with group or component management that he or she judges necessary to support an audit opinion and conform with other ISAs. An inability to obtain sufficient audit evidence whose possible effect is material and pervasive during an audit should prevent the auditor from giving an unqualified “clean” opinion and should be referred to those charged with governance as soon as such a condition becomes apparent and cannot be resolved.

**4. Is the proposal to move the guidance originally contained in the proposed IAPS to the proposed ISA appropriate?**

We are pleased to see an approach that provides integrated guidance for group audits in a single document but have a number of comments regarding content or organization of the standard, as follows.

We note one instance where important guidance in the IAPS was not brought forward to the ISA – in the 2003 Exposure Draft of the then-proposed ISA 600 and IAPS, paragraph 69 of the IAPS stated that when the group auditor’s risk assessment and scoping of work includes an expectation that group-wide controls are operating effectively, the group auditor performs or requires a related auditor to perform tests of controls to obtain sufficient appropriate audit evidence that the controls are operating effectively. In our review of the 2005 ED, we can find no such requirement. We find only statements regarding obtaining an understanding of such controls (which also appeared in the old IAPS.). We

think it is fundamental that an auditor who is relying on an assumption that controls are operating effectively must test controls to support that assumption.

In regard to financial significance of a component, all our members believe that the automatic reliance on a 20% presumptive percentage contained in paragraph 16 is not appropriate as a presumptive benchmark for judging financial significance. We believe that components much smaller than 20 % could often be financially significant and that if an illustrative benchmark is retained, it should be a much smaller percentage. Some of our members would prefer that no numerical benchmark be included. We would urge in all cases that greater emphasis be given to qualitative as well as quantitative factors, and that a statement be made that no simple quantitative rule is sufficient to support a presumptive judgment without consideration of qualitative factors.

As to organization of the proposed standard, we are concerned that the flow of guidance in it may not always be easy to follow. This ISA will constitute the fundamental basis of the audit opinion of very large and complex international groups, with sometimes hundreds of subsidiaries, branches, ventures, and other components and we believe it would be helpful to arrange the guidance in the ISA in a way that would follow the typical flow of work in an audit. For example, the texts in paragraphs 58, 59, and 60, and 62, contain some references to considerations and actions that would need to take place very early in the audit, even in the planning stage. We believe it would be helpful to put such guidance in the beginning of the ISA.

#### ***Other Comments on the Proposed ISA 600***

##### ***Components that are or are not significant.***

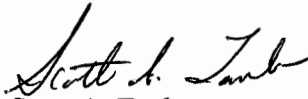
Some of our members find it difficult to understand the distinction made between Components that are Not Significant in the Aggregate (paragraph 54) and the remaining components (paragraph 55) and wonder if this will be workable. We would urge that the standard not convey the impression that the auditor may presumptively decide not to audit anything in such smaller components by limiting procedures to analytical procedures performed at the group level as described in paragraph 54. Even with components that are relatively small financially, the auditor should consider all factors both quantitative and qualitative in deciding not to audit any specific portion of an entity. We recognize that paragraph 15 makes mention of qualitative reasons a component may be significant even if it is not of individual financial significance, but this coverage is relatively brief.

##### ***Independence of all auditors used in a listed company audit***

Paragraph 27 requires the group auditor to consider the independence of the other auditor. This requirement is then carried through in paragraph 29 where it is stated that the group auditor's consideration of the independence of the other auditor "will affect the nature, timing and extent of the group auditor's involvement in the other auditor's work." However, there is no reference to independence in paragraphs 60 and 66 where the involvement in the work of other auditors is considered. This implies it is of lesser importance than the professional qualifications and competence of the other auditors. We would suggest that auditor independence is just as important and therefore should be included in paragraphs 60 and 66. In addition, there is little guidance for the group auditor on what to do if there are issues about the independence of the other auditor, which we believe is needed.

This concludes our comments on the proposed standard on The Audit of Group Financial Statements. We recognize that the Board is seeking to improve a standard that addresses many complexities in auditing and we are available to discuss and elaborate on any of our comments in this letter as needed. Please do not hesitate to contact me or Susan Koski-Grafer on 202-551-5300, or any member of the SC 1 Auditing Subcommittee, if any further information is needed.

Sincerely,



Scott A. Taub  
Chairman,

IOSCO Standing Committee No. 1