



Organización Internacional de Comisiones de Valores  
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May 3, 2004

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

Re: Proposed Revised International Standard on Auditing 600 (Revised), "The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements", and IAPS "The Audit of Group Financial Statements"

Dear Mr. Sylph:

IOSCO's Standing Committee No. 1 on Multinational Disclosure and Accounting (SC 1) is writing to comment on the Exposure Drafts of proposed IAS 600 and related IAPS on the Audit of Group Financial Statements. The main body of this letter includes discussion of our major comments, while the attachment includes more detailed comments.

IOSCO is committed to promoting the integrity of international markets through promotion of high quality accounting, auditing, and professional standards. This letter provides comments on which we have achieved a consensus among members of Standing Committee No. 1 and is not intended to include all the comments that might be provided by individual members on behalf of their respective jurisdictions.

As securities regulators charged with protecting the interests of investors in the global capital markets, we appreciate the opportunity to comment on this proposed standard and provide our perspectives. With many large and complex multinational companies active in cross-border financing activities, investors in the global markets have many choices and need high quality information to make investment decisions. The assurance provided by the audits of group financial statements is a critical factor in achieving high quality financial reporting and promoting investor confidence.

The International Standard on Auditing for Group Audits should contain clear and rigorous requirements for conducting a high quality audit when more than one auditor is involved in the audit of group financial statements. We believe that additional guidance is needed in this standard for both sole responsibility and divided responsibility audits.

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### *Responsibilities of the Group Auditor*

We believe that a core principle is that the auditor who signs the audit opinion - the “group auditor” (main auditor) as described in the proposed ISA and IAPS, must gather sufficient appropriate audit evidence to reach a conclusion and render an opinion on the consolidated group financial statements as a whole. This obligation of the group auditor should not be reduced because another auditor participates in part of the audit, whether or not that other auditor is mentioned and identified as having audited a component of the group entity in the group auditor’s report. An essential factor in performing a high quality group audit is that the main 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 financial significance of the individual components and determine those that contain significant risks related to the whole group. In addition, the group auditor should directly perform the work on components that include significant risks related to the whole group.

### *Sole Responsibility versus Divided Responsibility*

We recognize that the Exposure Draft (ED) has presented guidance for two approaches for conducting and reporting on Group Audits. We do not object to the existence of two approaches, although a majority of our members favor the sole responsibility approach. We are, however, very concerned that the ED appears to make the assumption that the amount of work done in a group audit under a divided responsibility approach requires lesser diligence by the auditor as it appears to require a lesser quality and/or quantity of evidence. We are also concerned that the ED provides less guidance for the divided responsibility approach.

For example, we believe that paragraphs 10-14, and 25-28 in the ISA, now directed only at sole responsibility audits, should also be applicable to divided responsibility audits. In addition, the entire International Auditing Practice Statement (IAPS), which contains important guidance that should also be included in the body of the Auditing Standard, is presented as not applicable to the divided responsibility approach. We believe that much of the IAPS should be merged into the body of the auditing standard and that the guidance should be equally applicable to both sole and divided responsibility group audits.

In accepting both the sole and divided responsibility approaches, the international standard must take care to put the both approaches on the same plane by providing clear and sufficient guidance to conduct a high quality group under either approach.

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 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 the 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.

#### *Mention of the Use of Other Auditors in the Auditor's Report*

Relying on the basic assumption that the work performed is the same in both a sole and divided responsibility group audit, users will expect that the same high degree of audit quality and accountability could be achieved in all circumstances. Those jurisdictions that believe that the sole responsibility approach provides greater accountability would continue to have or establish that approach as a requirement. Jurisdictions that believe that the divided responsibility approach can offer greater transparency regarding the use of other auditors in group audits could continue to allow that approach in cases where they believe it is appropriate. Separate guidance for a division of responsibility would, by and large, be unnecessary and if included in this ISA would likely focus on the circumstances that may give rise to the need for a divided responsibility approach and what type of report is given if that approach is used, rather than what type of audit work is done.

#### *International Convergence Issues*

The IAASB has cited convergence among national and international standards as a factor in its decision to provide coverage of both sole responsibility and divided responsibility approaches in the ED on group audits. Our members recognize and support the value of working toward convergence as part of developing high quality international auditing standards. In many jurisdictions, national auditing standards will continue to be developed and used for the foreseeable future. It would be beneficial to auditors, issuers, and investors to have national and international auditing standards be more similar and of high quality. We do not believe, however, that convergence should ever be used to justify usage of an audit approach, including divided responsibility, if Board members believe such an approach would produce inferior audits. As currently drafted, the ED could be read in that manner. If divided responsibility audits are permitted in the ISA, it should be because the Board has concluded that such an approach can be used to produce high quality audits with the right guidance. We believe the suggestions above will make it clear that whether a sole or divided responsibility is selected, the audit quality will be the same.

#### *Definitions of Group Auditor, Related Auditor, and Other Auditor*

It is critical that more work be done in the proposed ISA 600 and IAPS to define what is meant by a “related auditor”. This should include consideration of criteria for what constitutes an “audit firm network”. There may be appropriate differences in the degree of diligence and the amount of work done to verify another auditor's qualifications, as well as the nature of communications and supervisory actions that are needed when a group auditor is conducting an audit with a closely related auditor *and is properly able to utilize consistent firm-wide controls that are in place for both auditors*. However, the necessary guidance for the group auditor to make this determination is highly interrelated with the definitions of and requirements for “related auditors” and “firm networks”.

*We believe that the term “related auditor” as used in this ISA should be reserved for cases where that auditor is part of the same firm under common legal control and shares the same administrative and internal control policies and quality control system. This definition could possibly be extended to include a very closely affiliated (not loosely affiliated) firm that operates with a common set of operating control and quality control procedures and has agreements regarding cooperation and exchange of audit documentation and processes. Under these conditions, a commonality of traits could exist to the extent that would be the case in a single firm. Even with a firm-wide system however, we*

are not comfortable with treating a related auditor exactly the same as the group auditor. We believe there are still some necessary actions that the group auditor would need to carry out in order to verify the other auditor's qualifications and to supervise the audit work of the other related auditor. The necessary steps are contemplated in the ISA and IAPS on Quality Control. For example, if a "related auditor" is in another country that has different accounting and/or auditing standards from the parent group entity, the group auditor should ascertain that the related auditor has or obtains the necessary knowledge to support the group audit, including any conversion or reconciliation entries needed for proper consolidation into the group entity. Furthermore, the group auditor should also consider reviewing the related auditor's working papers when the related auditor is in charge of the audit of a material component or a component that includes significant risks related to the whole group.

In any case, the definition for a related auditor should NOT include a firm that has only a marketing agreement or a referral agreement with the group auditor's firm or parent firm. This point should hold even if the other auditor has its own independent quality control policies, even if such policies are stated to be in compliance with ISQC 1.

It is also critical that the proposed ISA 600 and IAPS clarify the term fundamental to this whole discussion, i.e., what is a "group auditor". Is this intended to refer only to an individual person, for example, the engagement partner on the group audit? Some of our members read the standard to refer only to the engagement partner. If this is not intended, what is the meaning of paragraph 7 (c), which refers to a related auditor as being, among other things, "another auditor in the group auditor's office"? If the term "group auditor" is intended to refer to more than one individual, precisely what is and is not included?

If the definition of related auditor is not clarified and tightened considerably with criteria similar to that which we have noted above, our view would be that a "related auditor" would have to receive the same due diligence consideration and treatment as an "other auditor".

#### *Use of Another Auditor*

We also believe that there should be additional specific requirements for circumstances where another auditor is used for certain procedures, with or without a full audit and audit report, including use in a sole responsibility audit. In addition to criteria established for the portion of the group entity that the group auditor must audit in order to assume the role of group auditor, there should be explicit guidance in the standard on coordination between the two auditors and on the documentation to be exchanged. There should be greater coverage of actions the group auditor should take to satisfy himself that the other auditor is performing acceptably; for example, the group auditor should obtain and consider descriptions of the other auditor's quality control process, rather than merely obtaining representations that the process is in compliance with ISQC 1. The desirability of visiting the other auditor should be discussed.

#### *Guidance in the ISA versus the IAPS*

As suggested above, we believe that the audit procedures discussed in the IAPS are equally relevant to sole and division of responsibility audits. Some of our members question whether a separate IAPS is really needed and believe it would be preferable to combine the ISA and IAPS into one complete and comprehensive document. All of our members believe that there are important portions of the IAPS that should be brought into the ISA. For example, the ISA should include guidance as to what portion of an entity must be directly audited by the main (group) auditor in order for the group auditor to assume the group auditor role.

Our attached comments on specific provisions in the IAPS address this issue in greater detail.

**Other Comments**

We believe addressing fully the matters we have identified in this letter would lead to substantive changes from the exposure draft and would also necessitate significant restructuring of the material presented. As such, we understand that if the Board takes on our suggestions, it will need to consider carefully whether the cumulative effect of the changes made is such that re-exposure for a further period of public comment would be appropriate.

The attachment to this letter contains additional comments on specific provisions in the ED and/or elaborates on comments we have already made. If you should have questions about any of these comments, please do not hesitate to call me or Susan Koski-Grafer on 202-942-4400, or any member of IOSCO Standing Committee No. 1.



Scott A. Taub  
Chairman, IOSCO Standing Committee No. 1  
On Multinational Disclosure and Accounting

## Attachment

### **General Comments regarding the Explanatory Memorandum and Detailed Comments on Proposed ISA 600 and the Related IAPS**

#### Comments regarding Proposed ISA 600

Paragraph 2 - Add a last sentence "Such scope of work may range from limited audit or review procedures to a full audit of a component and accompanying audit opinion.

Paragraph 5 – Delete this paragraph

Paragraph 6 – should be deleted, as with a revised and unified standard approach such a reference would no longer be needed.

Paragraph 7 Item (h) - The definition of "related auditor" seems much too broad, especially as the term is used later in the standard in the context of the group auditor having more comfort or reliance on a "related auditor" than on an "other auditor". Also, it is not clear whether (c) "group auditor" is referring to an individual or a group of people or a firm.

Paragraph 9 - As mentioned earlier in this letter, we are not comfortable with a related auditor being judged equivalent to the group auditor. Therefore it would seem more appropriate to have the phrase set off in commas read "including involvement in the work of related auditors", rather than "including the involvement of related auditors" as at present. Consequently, this paragraph should also contemplate the principle that the group auditor should ask itself to what extent it might be appropriate to perform the procedures on the related auditor's work listed in the bullet points.

Paragraph 10 – Add a final sentence "Depending upon the circumstances of the audit, audit procedures performed by another auditor may range from assigned procedures performed on a component and documented as requested by the group auditor and in accordance with ISAs, to a full scope audit of a component accompanied by an audit opinion."

Paragraphs 13 and 15 - both these paragraphs should make reference to paragraph 27 as well as paragraph 9, and the last sentence in paragraph should read as follows"...

When the group auditor is unable to participate in the work of the other auditor to the extent considered necessary, and is unable to arrange for the procedure described in paragraph 27, the group auditor does not accept the engagement.

Paragraph 17 – revise to include the requirement "...the group auditor should obtain an understanding of the quality control process used by the other auditor through a written description of such other process as well as a representation that the process complies with ISQC 1." We do not believe that the obligation to consider the quality control process can be satisfied by only obtaining a representation – the group auditor must have some other information that supports an understanding of the quality control system in place.

Paragraph 18 – The definition of related auditor in paragraph 7(h) is unclear. The definition as now written only makes sense if the definition of a group auditor is referring to an individual person, not a group of persons or a firm. Is this the case? (See also our comment regarding paragraph 7 (c). In

addition, this text only requires the group auditor and the related auditor to share common quality control procedures. Paragraph 18 refers to reliance on common procedures over a much wider range of matters. The definition of related auditor must be clarified, including the factors that must be present for an auditor to be considered a “related auditor”. Before relying on common traits, the group auditor needs to be assured or take steps to satisfy himself or herself that the traits are in fact common.

Paragraph 19 - The last sentence seems unclear or superfluous and should be clarified or deleted.

Paragraph 20 – What is intended by the standard in the case of equity investments in listed companies is unclear. Is it intended that the auditor should go beyond obtaining the audited financial statements of such public listed companies to calculate the per cent share of net income and equity attributable to the group owner? If so, what additional information should be obtained and why? It may be desirable to add at the end of the last sentence “...and whether or not it is possible to conduct the audit under such limitations.”

Paragraph 20 - Add a statement to the effect that “where the group auditor’s access to component management or component information is limited, the group auditor should consider not only the impact of the scope limitation on the auditor’s report but also whether the restrictions call into question the basis of preparation of the group financial statements. Failure by group management to procure sufficient access by the group auditor to conduct the audit may indicate that there is insufficient control or influence for the entity to be considered as a subsidiary or an associated company under the financial reporting framework, or that material control deficiencies exist.”

Paragraph 21 – add in the middle of the second sentence “... sets out the scope of work to be performed by each auditor, the timing for procedures to be performed, and the documentation to be supplied to the group auditor, as well as the acknowledgements and confirmations...etc.” (as in the remainder of the sentence.) Also, we question why the acknowledgement that the group auditor will rely on the work of the other auditor is not obtained from “related auditors” as well as “other auditors”.

Paragraph 21 should also include the need to include other auditors in the discussions about the entity and audit risk matters, and/or to inform them about the results of such discussions.

Paragraph 22 (d) add “and any documentation necessary to support such audit work”

Paragraph 23 - This is a somewhat vague and general statement. If it is retained, it needs to be laid out more clearly and/or supplemented with some illustrations or examples of what is being alluded to.

Paragraph 27 – The last part of the first sentence “...the group auditor reviews or requires a related auditor to review the other auditor’s working papers” should read, “the group auditor should review the other auditor's working papers.” The group auditor should review the working papers of the other auditors in the circumstances described in this paragraph. This would allow the group auditor to gain direct insight into the riskiest areas of the group and to evaluate all the problematic areas of the group as a whole. Allowing a related auditor to review the working papers of the other auditors does not satisfy this obligation as this would not allow the group auditor to gain the necessary direct insight, so this alternative should be eliminated.

Second sentence should read, “In the case of components that are likely to include significant risks of material misstatement, the group auditor considers the adequacy of the work performed and documented in the working papers in light of the assessed significant risks.”

Paragraph 35 – This paragraph should be deleted.

Paragraph 37 – Delete, as this paragraph would no longer be needed.

Paragraph 38 - Delete

### Comments regarding the IAPS

Our overarching comment on this IAPS is that much of the content therein would be useful to include in the ISA on Group Audits, and that some of the information should definitely appear in the ISA.

Paragraph 11 – Add a sentence at the end to state “If the group auditor or related auditor does not directly perform work on such components, the group auditor arranges for participation in or review of the work performed by other auditors as described in paragraph 27 of ISA 600.

Paragraph 15 – Revise the last sentence to read “Where the group auditor is unable to participate in the work of the other auditor to the extent considered necessary and is unable to arrange for alternative procedures as described in paragraph 27 of ISA 600, the group auditor does not accept the engagement.

Paragraph 17 (b) add to the sentence “and the group auditor will communicate such limitations to those charged with governance of the entity.”

Paragraph 18 – revise the last sentence to read, “...scope limitation that may impact the ability to complete the audit and/or the auditor’s report on the group financial statements. Such a scope limitation may also be an indication of a material deficiency in internal control.”

Paragraph 48 - add to the end of the first sentence “...and a description of the means whereby such knowledge has been obtained.”

Decision chart on page 35 – The right-hand box opposite “remaining components” should also contain the phrase “Analytical procedures performed at the group level”

Paragraph 65 – the first sentence should be revised to read “...due to fraud caused by improper revenue recognition and other fraudulent reporting, and to respond to the risk of management override of controls.”

Paragraph 68 - add at end of sentence “...and the documentation and/or opinion to be provided.”

Paragraph 85 – add at end of sentence “...and those charged with governance.”

Paragraph 88 – Fourth bullet. Since “group management” (and “component management”) are defined in the ISA and IAPS as “being management responsible for the preparation of financial statements” (and financial information), the way this is written could be interpreted as excluding the auditor from being obligated to report fraud discovered among operating management.. This should be clarified.

Appendix 2 – *Matters Relevant to the Related Auditor’s or Other Auditor’s Communication* – This should be revised to read “The form and content of the report or memorandum to be provided to the group auditor, and the documentation to accompany the audit opinion of the other auditor, if a separate audit opinion is to be obtained.”



Appendix 3 - this appendix should be revised to illustrate descriptions that would be provided of the means whereby the other auditor has obtained the understanding of the IFAC Ethics Code, and descriptions of other professional qualifications and quality control processes of the other auditor.