

2 October 2020

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Dear Willie

***IAASB Exposure Draft – Proposed ISA 600 (Revised), Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)***

Thank you for the opportunity to comment on this Discussion Paper. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) to the specific questions raised in the attachment.

The External Reporting Board (XRB) is an independent Crown Entity responsible for developing and issuing accounting and auditing and assurance standards in New Zealand. The XRB's outcome goal is to contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance framework that engenders confidence in New Zealand financial reporting, assists entities to compete internationally and enhances entities' accountability to stakeholders. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards.

The NZAuASB undertook various outreach activities to obtain feedback from its constituents on the ED, including a webinar and one-on-one interviews with practitioners from both small and large firms. The NZAuASB also considered the relevant academic research findings included in the Accounting and Finance Association of Australia and New Zealand (AFAANZ) submission to the NZAuASB (which is identical to the AFAANZ submission to the IAASB). This feedback helped inform the NZAuASB in developing its response.

The NZAuASB supports the IAASB's proposals to revise ISA 600. The NZAuASB acknowledges the importance of some of the other recent IAASB's activities to improve the quality of audits of group financial statements, in particular the revisions of ISA 220, *Quality Control for an Audit of Financial Statements*, *Quality Management at Firm Level - ISQM 1* and *Engagement Quality Reviews, ISQM 2*.

The NZAuASB also notes that the proposed standard has been unable to fully address many of the practical challenges that inspired the revision of the standard (e.g. access issues and documentation issues). The circumstances caused by COVID 19 further demonstrate the need for active involvement of all key stakeholders to address issues of audit quality that cannot be resolved by any single party. It is therefore important for the IAASB and its task force to continue the conversation on audit quality with respect to group audits, so that the final standard can address the practical challenges as far as it is possible to do so, with an eye also to implementation guidance once the standard have been issued.

We are very interested in this project and are happy to offer our assistance to the task force if needed. Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk ([sylvia.vandyk@xrb.govt.nz](mailto:sylvia.vandyk@xrb.govt.nz)).

Yours sincerely,



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## Submission of the New Zealand Auditing and Assurance Standards Board

### IAASB Exposure Draft – Proposed ISA 600 (Revised)

#### I Schedule of Responses to the IAASB's Specific Questions

1. **Question 1: With respect to the linkages to other standards:**
  - (a) Does ED-600 have appropriate linkages to other ISAs and with the proposed ISQMs?
  - (b) Does ED-600 sufficiently address the special considerations in a group audit with respect to applying the requirements and application material in other relevant ISAs, including proposed ISA 220 (Revised)? Are there other special considerations for a group audit that you believe have not been addressed in ED-600?

#### **Response:**

The NZAuASB is of the view that there is a mixed result in this regard. In some areas ED-600 is successful in achieving the objectives stated in the question 1. These include:

- Paragraphs 15 to 17 and corresponding application guidance, which address special considerations in applying ISA 2101, specifically considering access issues.
- Paragraph 24 and corresponding application guidance, which address how applying the requirements of ISA 315 (Revised 2019) for understanding the entity and its environment, the applicable financial reporting framework and system of internal controls may have specific considerations for a group audit. The application material to support paragraph 24 is directly relevant to a group engagement, and provides necessary and helpful guidance for conducting a group engagement (e.g. by referring to risks that are particularly relevant to a group structure; special considerations that apply when a group prepares consolidated financial statements; and some significant elements for internal controls in a group structure and how they may affect audit).
- Paragraph 29 and corresponding application guidance, which address a special form of materiality that would only apply in a group audit situation (i.e. the component performance materiality).
- Paragraph 55, which addresses how the requirements in ISA 2652 for communicating significant audit findings apply to audit findings at a component level.

However, there are other instances where ED-600 is not as successful in achieving the stated objectives. For example:

1. Paragraph 31 simply reminds the group auditors that they are responsible for applying ISA 315 (Revised 2019) when identifying and assessing the risks of material misstatements. The application guidance (paragraphs A78) repeats what is already in ISA 315 (Revised 2019) without adding anything specific to group audits. The same is true for paragraph A80, where guidance already included in ISA 240<sup>3</sup> is repeated.

Specific considerations in applying these standards in group audits seem to arise when component auditors are involved. Paragraph 32 of the ED does address these considerations. In this light, paragraph A79 is also superfluous and could be built into paragraph A82. However, even then, the requirement could be clarified by specifically requiring the group auditor to:

- i) Consider whether they should involve component auditors in risk identification and

<sup>1</sup> ISA 210, *Agreeing the Terms of Audit Engagements*

<sup>2</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

<sup>3</sup> ISA 240, *The Auditors Responsibilities Relating to Fraud in an Audit of Financial Statements*

- assessment at component level (we note that Appendix 1 provides appropriate guidance to help auditors in this relation).
- ii) If yes, consider what are the respective responsibilities and how best to have these communicated, documented and evaluated etc.
2. In a similar fashion paragraph 33 simply reminds auditors that they are required to apply ISA 330. The real considerations of applying ISA 330 for group engagements include:
    - i) Should they involve component auditors as part of their response? (In this respect, we note that paragraphs A86 to A90 provide relevant and useful guidance about this.)
    - ii) If yes, what are the respective responsibilities and how best should they be communicated, documented and evaluated? (Paragraphs A96 to A101 provide useful and relevant guidance in this regard.)
  3. Paragraph 47, relating to applying ISA 5604, is similarly void of any specific group engagement connection.

ED-600 does seem to provide strong linkage to ISA 220 (Revised). Paragraphs 12 (relating to leadership responsibilities), 20 (ethical requirements), 21-22 (engagement resources), and 23 (engagement performance) all link to ISA 220, and the corresponding application material provides relevant and helpful guidance.

Despite that, the application guidance lacks a comprehensive framework to reflect how ISA 220 requirements may apply to a group audit. The NZAuASB considers that it may be helpful to provide specific guidance for the group auditor to look at the application material through different “lenses”, for example:

Lens	Aspects to consider
Who are the component auditors?	<ol style="list-style-type: none"> <li>1) Same firm, network firm, different firms</li> <li>2) Similarity of regulatory and audit monitoring environment</li> <li>3) Similarity of cultures, languages, education system etc</li> </ol>
What is their expected level of involvement?	<ol style="list-style-type: none"> <li>1) High (e.g. in all stages of audit)</li> <li>2) Moderate (e.g. fully involved in some stages)</li> <li>3) Low (limited involvement to perform specific procedures)</li> </ol>
What is the expected level of assignment of responsibilities?	<ol style="list-style-type: none"> <li>1) High (e.g. highly competent with in-depth knowledge of the component trusted with high level of autonomy in how they go about their responsibilities)</li> <li>2) Moderate (e.g. the group engagement team provides principle-based instructions and allows a moderate level of autonomy to the component auditor)</li> <li>3) Low (detailed and comprehensive instructions for the component auditors regarding their responsibilities)</li> </ol>
What is the expected level of impact from the involvement of the component auditor on the overall audit conclusion?	<ol style="list-style-type: none"> <li>1) High (e.g. audit evidence from the work undertaken by the component auditor is a major contributor to the group auditor’s conclusion about a significant risk at the group financial statements)</li> <li>2) Moderate</li> <li>3) Low</li> </ol>
What is the expected level of access to the underlying information?	<ol style="list-style-type: none"> <li>1) High (e.g. access to the audit file as if it were in the group engagement team head office)</li> <li>2) Moderate (e.g. a good level of access, but not to all documents)</li> <li>3) Low (significant restrictions)</li> </ol>

4. Finally, in relation to other special considerations that may apply to a group audit engagement, we would like to draw attention to matters highlighted by the Accounting and Finance Association of Australia and New Zealand (AFAANZ) in its response to the IAASB, specifically how factors

<sup>4</sup> ISA 560, *Subsequent Events*

affecting audit team identity in distributed teams may affect the team communications and relationship dynamics between team members. The NZAuASB's stakeholders also cite as one of the most significant practical challenges in group audits the challenges in leading an engagement team that is composed of members distributed across locations with different characteristics (e.g. different languages, time zones or cultures). The NZAuASB is of the view that it is impractical for an auditing standard to appropriately address such challenges, and would encourage the IAASB to consider developing guidance on the importance to audit quality of having a shared team identity, characteristics and factors that may enhance or impeded the team's development, and how these characteristics/factors can be reinforced/managed.

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

**Response:**

**Response:**

The NZAuASB supports the placement of sub-sections through ED-600, as it helps the flow of the standard. Nevertheless, the NZAuASB also suggests including all the requirements relating to involving component auditors in a separate appendix.

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

**Response:**

The NZAuASB acknowledges that ED-600 does emphasise the importance of professional scepticism. However, it may be helpful to provide some examples of potential impediments to professional scepticism that may apply in a group audit engagement: for example, by drawing the attention of the group auditors to potential impediments that may impact the component auditor's exercise of professional scepticism and how they can be addressed. Examples of such potential impediments may include:

- Pressure to complete a component audit in a short time to meet deadlines determined by the group engagement team.
- Unconscious bias as a result of believing it is the group auditor's role to be professionally sceptical and the component auditor's to simply follow instructions from the group.
- Perceived differences between the group engagement team's professional prestige, or fear of reprisal, may deter component auditors from challenging the accuracy and appropriateness of the instructions they receive, even when they find them inadequate or inaccurate.

The NZAuASB also draws attention to the AFAANZ submission, which draws particular attention to research evidence on team dynamics and team identity in a multi-national group audit engagement and how such dynamics might threaten or reinforce the exercise of professional scepticism in group audits. The academic research in this area highlights challenges that a group engagement team may encounter in fostering a team identity that enhances audit quality.

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

**Response:**

The definition of group financial statements is clear and straightforward to apply where the audited entity must account for its interest in other separately structured entities in accordance with the

applicable financial reporting framework. The NZAuASB supports ED-600 to link the definition of group financial statements with aggregation requirements under the applicable financial reporting framework (including consolidated entities, joint arrangements, and associated entities as well as consolidation of entities under common control).

However, using the consolidation process to scope in group structures other than those mentioned above (e.g. the case of branches or divisions that are not formal separate structures) may be problematic. According to paragraph A17 of ED-600, whether such structures are scoped in or out revolves around how an entity's financial reporting system organises financial information. Consequently, if an entity uses financial information for several locations, that is aggregated using a separate system or process, that information may be scoped in. However, if the same entity designs its financial information system in such a way that geographical location is first part of the group's financial reporting system and then disaggregated by group management for operating purposes, there is no consolidation process and the audit may be scoped out of ISA 600. The NZAuASB believes that, in such circumstances, professional judgement is required to carefully consider the engagement circumstances to determine whether a group structure exists and, consequently, what parts of ISA 600 would apply.

The NZAuASB suggests a two-step approach to determine whether group financial statements exist:

1. For separately structured entities, where the applicable financial reporting framework requires aggregation of each entity's financial statements into group financial statements via consolidation, proportionate consolidation, or the equity methods of accounting.
2. For internally structured business units (e.g. branches and divisions), the auditor exercises professional judgement in determining whether ISA 600 applies. In making such determination, the auditor considers the following:
  - i. Specific inherent risk factors (paragraph A56 of the ED includes a good list of these risk factors).
  - ii. Whether there is a need to aggregate the financial information of such units in a way that involves elimination of inter-unit transactions and balances or accounting for different reporting periods.
  - iii. Specific considerations relating to understanding and evaluating the group's system of internal controls, including matters such as Commonality of Controls (A59-A63), use of Centralised Activities (A64-A65), and the entity's IT systems.
  - iv. The increased aggregation risk applying to materiality determination where there are many components.
  - v. Increased concerns for inadequate access to appropriate and sufficient audit evidence, especially when accepting or continuing an engagement
5. **Do you believe the proposed standard is scalable to groups of different sizes and complexities, recognizing that group financial statements, as defined in ED-600, include the financial information of more than one entity or business unit? If not, what suggestions do you have for improving the scalability of the standard?**

**Response:**

The NZAuASB believes ED-600 is scalable.

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

**Response:**

The NZAuASB supports the ED-600 requirement to take an "auditor view" of the group for the

purposes of planning and performing the group audit.

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

**Response:**

The NZAuASB supports the approach in ED-600 to differentiate between restrictions on access to information and people that are outside the control of group management and those that are imposed by group management. The NZAuASB also notes that restrictions on access imposed by management are not unique to group audits, and that paragraph 7 of ISA 210<sup>5</sup> specifically addresses such situations, including the required responses from the auditor. Such instances of management-imposed restrictions are generally referred to as a “management-imposed limitation” in ISA 210 and ISA 705.<sup>6</sup> It may be helpful to adopt this terminology in ED-600 as well. Accordingly, the NZAuASB suggests the following changes to paragraphs 16 and 17 of ED-600:

*Restrictions on Access Outside the Control of Group Management*

16. If the group engagement partner concludes that group management cannot provide the engagement team with access to information or unrestricted access to persons within the group due to restrictions that are outside the control of group management, the group engagement partner shall consider the possible effects on the group audit. (Ref: Para. A27—A32):
- i) Whether and to what extent the group engagement team can overcome the effects of such restrictions on access to information or people (ref: paragraph A27-A29); and
  - ii) the possible effects on the group audit of being unable to do so (ref: paragraph A30-A32).

*Limitation of Scope imposed by Group Management*

- ~~17. If the group engagement partner concludes that: (a) It will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and (b) The possible effect of this limitation will result in a disclaimer of opinion on the group financial statements, the group engagement partner shall either: (i) In the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement, where withdrawal is possible under applicable law or regulation; or (ii) Where law or regulation prohibit an auditor from declining an engagement or where withdrawal from an engagement is not otherwise possible, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: Para. A31—A33)~~
17. In applying ISA 210, If group management impose a limitation on the scope of the group engagement team’s work in the terms of a proposed group audit engagement by restricting access to information or people, such that the group engagement partner believes the limitation will result in the group auditor disclaiming an opinion on the group financial statements, the group engagement partner shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so. (refer para A31-A33)

The NZAuASB supports including additional guidance to help group auditors overcome restrictions not imposed by group management. However, the NZAuASB believes that the

<sup>5</sup> ISA 210, *Agreeing the Terms of Audit Engagements*, paragraph 7.

<sup>6</sup> ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*, paragraphs 11 to 14.

guidance in paragraph A29 on alternative approaches to address access restrictions relating to non-controlling interests in a component (e.g. equity method accounted-for investments) needs further clarification. For example, it may be helpful to clarify that the group auditors need to apply their professional judgement to evaluate whether the suggested actions mentioned in this paragraph (such as using information that the entity might have gathered, or using publicly available information) are adequate to offset the impact of lack of access.

It may also be appropriate to remind the group auditor that such judgements are influenced by the associated risk of material misstatement and the sufficiency and appropriateness of available evidence to reduce the risk to an acceptably low level. The examples given in paragraph A29 of actions to overcome access restrictions in non-controlling interests seem only appropriate for low risk equity investments, and it may be prudent to clarify this.

Finally, as noted by the IAASB and the ISA 600 Task Force, access issues for entities that are not under the group's control (e.g. associates accounted for using the equity method of accounting) are likely to continue to be a challenge in practice, and the NZAuASB acknowledges that it will not be practical for an auditing standard to address all these challenges. But it is important for the IAASB and the Task Force to continue the conversation on these issues, so that the final standard can address the practical challenges as far as it is possible to do so, with an eye also to implementation guidance once the standard have been issued

- 8. Will the risk-based approach result in an appropriate assessment of the risks of material misstatement of the group financial statements and the design and performance of appropriate responses to those assessed risks? In particular, the IAASB is interested in views about:**
- (a) Whether the respective responsibilities of the group engagement team and component auditors are clear and appropriate?**
  - (b) Whether the interactions between the group engagement team and component auditors throughout the different phases of the group audit are clear and appropriate, including sufficient involvement of the group engagement partner and group engagement team?**
  - (c) What practical challenges may arise in implementing the risk-based approach?**

**Response to questions 8 (a) and (b)**

ED-600 allows the group engagement team to assign a significant portion of risk assessment and risk response stages of the audit to component auditors while clarifying that the group engagement team is responsible for such assigned work. In the NZAuASB's view, while this is clear, practical issues are likely to arise in relation to how the group engagement team:

- 1) Considers the appropriateness and sufficiency of work performed by component auditors (the higher the degree of assigned work, the greater the need for a more robust evaluation).
- 2) How, and to what extent, such evaluation and the consequent conclusions are documented.

Paragraph A126 of ED-600 provides some guidance on the matters that must be documented, but as expected (given the nature of the issue and the wide spectrum of possible circumstances) the level, extent and nature of such documentation is a matter of professional judgement. So while respective responsibilities are conceptually clear (i.e. the group engagement team is responsible for all audit matters as if they performed all of the audit themselves), it will remain a significant challenge to demonstrate the adequate level of direction, supervision and review of component auditors' work and documentation and other necessary ongoing involvement in their activities.

We further consider that ED-600 does not clearly explain the meaning of performing audit procedures on the entire financial information of the component. We note that paragraph A98 explains that the component auditor may need to consider the sufficiency and appropriateness of



audit evidence obtained in performing further audit procedures with respect to the financial statements. There seems to be a lack of clarity in specifying what is the objective of assigning performance of audit procedures on “entire financial information of a component”. For example, it is unclear whether ISA 600 expects the component auditor to obtain reasonable assurance that the component financial information as presented to be included in the group accounts is free from material misstatement. The NZAuASB recommends that the IAASB clarify whether this approach is meant to signify a full-scope reasonable assurance engagement.

**Response to question 8 (c)**

The NZAuASB has not identified any other practical challenges that may arise in implementing the risk-based approach at this stage.

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

**Response:**

The NZAuASB supports the additional application material on the commonality of controls and centralised activities.

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

**Response:**

The NZAuASB supports the ED-600 approach to component performance materiality. The NZAuASB encourages the IAASB to consider whether some practical examples can be included in implementation guidance to help a better understanding of the concept.

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

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

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

**Response:**

The NZAuASB supports the enhanced requirements and application material on documentation.

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

**Response:**

The NZAuASB would like to draw the IAASB’s attention to recent research indicating that users of group financial statements are interested to know about whether component auditors were involved in the group audit and how their involvement is managed. The NZAuASB notes that communication of matters ancillary to the outcome of the audit (such as fees and the firm’s approach to quality management) to users is an ongoing issue internationally. It may be that more information and evidence is needed before an informed decision can be made about how

best to communicate the involvement of component auditors in a group audit. The NZAuASB is aware of the differing views about whether such disclosures (and the use of other mechanisms such as transparency reports) are more a matter of a regulatory response or for an auditing standard. The NZAuASB urges further consideration of the matter, noting that transparency remains an important factor in the public interest. However, the NZAuASB considers it important that the primary emphasis is on the group engagement partner's responsibility.