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June 21, 2022

By email: CommentLetters@aicpa-cima.com

Ms. Sara Lord
Auditing Standards Board
American Institute of Certified Public Accountants
1345 Avenue of the Americas, 27th Floor
New York, NY 10105

RE: Proposed Statement on Auditing Standards, Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)

Dear Ms. Lord:

We appreciate the opportunity to provide comments on the Auditing Standards Board's (the Board) Proposed Statement on Auditing Standards *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* (the proposed SAS).

Overall, we are supportive of the proposed SAS and commend the Board's effort. A risk-based approach to planning and performing a group audit engagement allows greater flexibility, improved scalability and ultimately enhancement in audit quality. We acknowledge and appreciate that the proposed SAS reflects the Board's strategic convergence with the International Standard on Auditing 600 (Revised), *Special Considerations – Audit of Group Financial Statements (Including the Work of Component Auditors)* (ISA 600 [Revised]), while at the same time considers standards of other standard setters and balances the jurisdictional needs specific to the United States.

Within this letter we have provided observations on predominant themes and have included in the appendix detailed responses to certain questions on which the Board requested feedback.

Group auditor's direction, supervision, and review of component auditors of equity method investments (EMI)

As further explained in our response to question 9 in the appendix, the requirement for the group auditor to exercise the same level of direction, supervision, and review of the component auditors of an EMI as the component auditors of a consolidated entity have always been, and continue to be, a challenging area in practice on group audit engagements. In general, group management has less power, influence, and oversight over the EMI, particularly when compared to a consolidated entity. As a result, the same challenges extend to the group audit engagement, where the group auditor has less inherent ability to direct and oversee the component auditor of the EMI. These practical challenges exist under extant AU-C section 600 and will continue under the proposed SAS.



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We note that this issue was deliberated as part of the PCAOB's standard-setting project, *Supervision of Audits Involving Other Auditors*. In the PCAOB's Second Supplemental Request for Comment (2021 SSRC)¹, the PCAOB proposed to define a new term *investee auditor* and clarified that the financial statements audited by the investee auditor, whose report is satisfactory to the investor's auditor, may constitute sufficient appropriate audit evidence.

We submit to the Board to consider whether a similar proposal to the PCAOB's 2021 SSRC may be beneficial by revising the proposed SAS and incorporating the relevant requirements for the investee auditor into AU-C 501.05, *Investments in Securities When Valuations are Based on Investee's Financial Results*. We acknowledge that our proposal for the Board to align with the PCAOB in this area would create a divergence from the ISA 600 [Revised]. However, we believe the Board has an opportunity to make enhancements in this area that are necessary and in the public interest in the United States to address practical challenges, and the ultimate improvement to audit execution and scalability will justify the divergence in this case.

Implication of the definitions of *referred-to auditor* and *component auditor* in relation to the proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (proposed QM SAS)

As further explained in our response to question 6 in the appendix, we seek further clarity on how the requirements in the proposed QM SAS apply to certain component auditors and referred-to auditors in a group audit engagement.

We believe there is inherent tension between: i) the requirements in the proposed QM SAS where the group engagement partner has specified responsibilities over the engagement team (which includes a *component auditor* under the definition in the proposed SAS); and ii) practical challenges in a group audit engagement as to how the group engagement partner may comply with such requirements in the proposed QM SAS when the component auditor is a non-network firm and therefore, not subject to the group auditor's system of quality management. This creates implementation challenges in practice, and we included a specific example in the appendix for illustrative purpose. As a result, we recommend the Board provide further practical application guidance of how the Board intends for a group auditor to comply with the QM SAS in different group audit scenarios, particularly when component auditors are involved that are under separate systems of quality management as they are not from the group firm's network. Such practical application guidance would be very helpful to drive consistent implementation and execution.

Lastly, we recommend the Board clarify that the group auditor does not have any responsibility related to the system of quality management of the *referred-to auditors* under the requirements of the proposed QM SAS, since *referred-to auditors* are not part of the engagement team under the definition of the proposed SAS.

¹ See [PCAOB Release No. 2021-005](#), section III Revisions to the proposed rule text, section G *Other Matters*, sub-section 1. Investee Financial Statements Audited by an Investee's Auditor, p.46-p.47 and p.A3-22.



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We appreciate the Board's consideration of our comments in support of enhancing auditing standards and audit quality. If you have any questions regarding our comments included in this letter, please do not hesitate to contact Halie Creps at 212-954-3622 or ccreps@kpmg.com or Doug Besch at 212-872-6641 or dbesch@kpmg.com.

Sincerely,

KPMG LLP



Appendix

Below are responses to select questions outlined in the proposed SAS for which we had specific input, recommendations, or concerns.

4. With respect to scalability of the proposed SAS

- b. do you believe that the guidance in exhibit A, “Relevancy of Requirements in Various Group Audit Scenarios,” of the proposed SAS is understandable and provides clarity on the relevancy of certain requirements of the proposed SAS in various group audit scenarios? Would the relevancy of certain requirements of the proposed SAS in various group audit scenarios be clear without exhibit A?**

The relevancy of certain requirements in the proposed SAS in various group audit scenarios is sufficiently clear without exhibit A because of the placement of sub-sections throughout the proposed SAS that highlight such requirements. Despite the introductory paragraphs in exhibit A reminding group auditors that they are “required to have an understanding of the entire text of this proposed SAS, including its application and other explanatory material, to understand its objectives and apply its requirements properly”, we have concerns over implementation in practice. Specifically, the content in exhibit A may be misinterpreted as if only the requirements presented in tabular format in exhibit A are applicable in various group audit scenarios, which could lead to misapplication of the proposed SAS and a negative impact to audit quality.

If the Board determines exhibit A should be retained in the final SAS, and as we understand exhibits to be authoritative in nature, we offer the following recommendation for the Board’s consideration to further enhance clarity of exhibit A. We note that the relevant requirements in tabular format begin with paragraph 12 of the proposed SAS. We recommend the Board to include references to paragraphs 1-11 as applicable for completeness, or further clarify why the relevant requirements included in exhibit A begin with paragraph 12 (when requirements in the proposed SAS start with paragraph 18).

6. Are the definitions of the terms *referred-to auditor*, *component auditor*, and *group auditor* clear, including as they relate to the definition of the term *engagement team* in the proposed QM SAS?

The definitions of the terms *referred-to auditor*, *component auditor*, and *group auditor*, within the context of the proposed SAS, are clear. However, how these definitions relate to the definition of the term *engagement team* in the proposed QM SAS is not clear, particularly in relation to how the requirements in the proposed QM SAS apply to certain component auditors and referred-to auditors in a group audit engagement.

We believe there is inherent tension between: i) the requirements in the proposed QM SAS where the group engagement partner has specified responsibilities over the engagement team (which includes a *component auditor* under the definition in the proposed SAS); and ii) practical challenges in a group audit engagement as to how the group engagement partner may comply with such requirements in the proposed QM SAS when the component auditor is a non-network firm and therefore, not subject to the group auditor’s system of quality management. We included a specific

example of the implementation challenges below.

Paragraph 35 and A25 of the proposed QM SAS state the following related to consultations:

35. The engagement partner should (Ref: par. A99–A102)

- a. take responsibility for the engagement team undertaking consultation on
 - i. difficult or contentious matters and matters on which the firm’s policies or procedures require consultation, and*
 - ii. other matters that, in the engagement partner’s professional judgment, require consultation;**
- b. determine that members of the engagement team have undertaken appropriate consultation during the audit engagement, both within the engagement team, and between the engagement team and others at the appropriate level within or outside the firm,*
- c. determine that the nature and scope of, and conclusions resulting from, such consultations are agreed with the party consulted, and*
- d. determine that conclusions agreed have been implemented.*

A25. When firm policies or procedures require specific activities to be undertaken in certain circumstances (for example, consultation on a particular matter), it may be necessary to communicate with individuals who are not personnel about what is expected of them to enable the engagement partner to comply with the firm’s policies or procedures. For example, in a group audit engagement, communicating the group auditor’s policies and procedures about matters subject to consultation to a component auditor enables the component auditor to determine which identified difficult or contentious matters that are relevant to the group financial statements to bring to the attention of the group engagement team.

While paragraph A25 provides additional guidance, it remains challenging for the group engagement partner to comply with the requirements in paragraph 35, especially when component auditors that are not part of the firm’s network are involved in the group audit engagement. A consultation requirement may be viewed as largely a firm-level quality management response, therefore making it difficult to comply at the engagement level when multiple firms are involved in a group audit engagement. For example, it would be cumbersome for a group engagement partner applying the guidance in A25 to communicate all the consultation requirements under the group auditor firm’s policies and procedures to enable compliance with the requirement in paragraph 35a. The group engagement partner will also be challenged in practice to verify compliance with paragraph 35b, c, and d that are at the component auditor firm’s level, particularly when the component auditor is not part of the group auditor’s firm network. The group engagement partner typically would not have sufficient visibility or knowledge of such component auditor’s firm’s system of quality management to rely on such component auditor’s firm’s consultation process. The alternative of requiring identification and communication of potential consultation matters at the component to the group auditor and applying the group auditor firm’s consultation process may be duplicative and cumbersome in practice.

As a result, we recommend the Board provide further practical application guidance of how the Board



intends for a group auditor to comply with the QM SAS in different group audit scenarios, particularly when component auditors that are not from the group auditor's firm network are involved and are under separate systems of quality management.

For example, we outlined below two possible approaches that the group engagement partner may undertake individually or in combination to fulfill their responsibilities:

- i. The group engagement team may adopt a top-down approach by obtaining information and evaluating the system of quality management of the non-network component auditor's firm (in accordance with *Proposed Statement on Quality Management Standards: A Firm's System of Quality Management*, paragraphs A136 - A137). The group engagement team may perform additional inquiries or other procedures, if needed, based on the evaluation of the information regarding the system of quality management. Once satisfied, the group engagement team can rely on the non-network component auditor's firm's system of quality management;
- ii. The group engagement team may obtain incremental reporting from the non-network component auditor, where the non-network component auditor provides detailed reporting on all consultations undertaken by the component auditor and potential consultation matters ("close calls") that were evaluated by the component auditor and ultimately not consulted by the component auditor. The group engagement team then evaluates whether the quality management practices with respect to consultations of the non-network component auditor are sufficient and appropriate for the group team's purposes.

As discussed above, it is currently unclear if either or both of the approaches outlined above are in line with the Board's intent and expectation of how a group auditor may comply with QM SAS. We believe that inclusion of additional practical application guidance is necessary to drive consistent implementation and execution.

Lastly, we recommend the Board clarify that the group auditor does not have any responsibility related to the system of quality management of the *referred-to auditors* under the requirements of the proposed QM SAS, since *referred-to auditors* are not part of the engagement team under the definition of the proposed SAS.

9. Do you agree with the application material in paragraphs A47-A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method? Are there additional requirements or application material relating to EMI that are needed in the proposed SAS and if so, what should they be?

Investments accounted for using the equity method (that is, EMIs) are considered components and the requirement for the group auditor to exercise the same level of direction, supervision, and review of the component auditor of an EMI as the component auditor of a consolidated entity has always been, and continues to be, a challenging area in practice on group audit engagements. This applies under both the extant AU-C section 600 and the proposed SAS. While paragraphs A47-A49 and A10 are helpful, we do not believe they fully resolve the implementation challenges as it relates to the group auditor's responsibilities over component



auditors of EMIs. While there is conceptual merit to treating the EMI as a component, the practical reality is that group management generally has less power, influence, and oversight over the EMI, particularly when compared to a consolidated entity. As a result, the same challenges extend to the group audit engagement, where the group auditor has less inherent ability to direct and oversee the component auditor of the EMI. These practical challenges exist under extant AU-C section 600 and will continue under the proposed SAS.

One example may be where the component audit of the EMI is already completed prior to the start of the group audit. In this case, the group auditor likely has no ability to direct or oversee the component auditor's work over the financial statements of the EMI that is already completed, and yet as stated in paragraph A10, "in any event, the requirements of this proposed SAS apply, including those relating to the direction and supervision of component auditors and the review of their work".

We note that this issue was deliberated as part of the PCAOB's standard-setting project, *Supervision of Audits Involving Other Auditors*. We observe that "under the proposed amendments in the PCAOB's 2016 proposal and the 2017 Supplemental Request for Comment, the investor's auditor in such equity method investment situations would have been in the position of a lead auditor [under PCAOB standards], and thus required to supervise the work of the investee's auditors in accordance with AS 1201" (i.e. the group auditor would be required to exercise the same level of direction and supervision over the component auditor of an EMI as the component auditor of a consolidated entity, consistent with extant AU-C 600 and proposed SAS). However, as discussed in the PCAOB's 2021 Second Supplemental Request for Comment (2021 SSRC)², the PCAOB acknowledged that it has received comments that "the investor's auditor may not be able to establish an arrangement with the investee's auditor or investee management under which the investor's auditor would direct activities of the investee's auditor and review its audit documentation or obtain information from investee management".

After considering the comments received, the PCAOB stated in the 2021 SSRC that they are "no longer proposing to require that the investor's auditor supervise the investee's auditor's work under AS 1201, for example, in equity method investment situations". "Instead, in such situations, the investor's auditor would look to the requirement of Appendix B of the evidence standard (AS 1105), which describe the auditor's responsibilities for obtaining sufficient appropriate evidence in situations in which the valuation of an investment is based on the investee's financial results." The 2021 SSRC includes proposed amendments to AS 1105 Appendix B paragraph B1 which states: "Financial statements of the investee that have been audited by an auditor ("investee's auditor") whose report is satisfactory, for this purpose, to the investor's auditor may constitute sufficient appropriate evidence." The 2021 SSRC proposed further amendments that "the [investor's] auditor may consider performing procedures such as making inquiries as to the professional reputation, standing, and

² See [PCAOB Release No. 2021-005](#), section III Revisions to the proposed rule text, section G *Other Matters*, sub-section 1. Investee Financial Statements Audited by an Investee's Auditor, p.46-p.47 and p.A3-22.



independence of the investee's auditor (under the applicable standards), visiting the investee's auditor and discussing the audit procedures followed and the results thereof, and reviewing the audit program and/or working papers of the investee's auditor".

Revising the proposed SAS and incorporating the relevant requirements for the investee auditor into AU-C 501.05, *Investments in Securities When Valuations are Based on Investee's Financial Results*, similar to the PCAOB's 2021 SSRC may be beneficial. The proposal outlined in the PCAOB's 2021 SSRC strikes the right balance by defining "investee's auditor" (i.e. component auditor over EMI) as a separate term and establishing a different level of group auditor requirements over the investee's auditor. This approach recognizes the reality that EMIs are different from consolidated entities and thus the group auditor's oversight of the audit of EMIs should be subject to differing requirements.

We acknowledge that the guidance in paragraph A173 of the proposed SAS provides one potential solution, where the group auditor can make reference to the audit of the EMI as referred-to auditor in response to the practical challenges outlined above. However, the PCAOB's 2021 SSRC also preserved the ability to make reference and we share the PCAOB's view that separate requirements for the investee's auditor are necessary in addition to the ability to make reference to referred-to auditor. We also acknowledge that our proposal for the Board to align with the PCAOB in this area would create a divergence from the ISA 600 [Revised]. However, we believe the Board has an opportunity to make practical enhancements in this area that are necessary and in the public interest in the United States. Such enhancements will address the group auditor's practical challenges related to direction, supervision, and review of component auditors of an EMI, and the ultimate improvement to audit execution and scalability will justify the divergence in this case.

12. Is the last sentence of paragraph A41 clear? Is there additional application material that is needed, and if so, what should it be?

We believe the last sentence of paragraph A41 can be enhanced as follows (please see strikethroughs and underlined text for proposed changes):

A41. As the magnitude of ~~and/or the risks of material misstatement to the group financial statements associated with~~ the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained.

This is consistent with the two bullets in paragraph A41, where the group engagement partner may consider both the financial significance of the components that are audited by the referred-to auditor, and the risks of material misstatement to the group financial statements associated with the portion of the company's financial statements audited by the referred-to auditor, when determining whether its participation may be sufficient to serve as group auditor.



13. Does the proposed effective date provide sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments, including sufficient time to support effective implementation of the proposed SAS?

We understand that consistent with the Board’s drafting conventions, early adoption of the proposed SAS is permitted when there is no explicit language that states otherwise. As a global network firm, the ability to early adopt the proposed SAS will be critical as we implement ISA 600 [Revised] with an effective date for audits of group financial statements for periods beginning on or after December 15, 2023.

We believe that the proposed effective date provides sufficient time to adopt the new standard and related conforming amendments.

Other comments related to ethical requirements, including those related to independence

We included additional comments below related to ethics requirements, including those related to independence, for the Board’s consideration.

- i. The International Ethics Standards Board for Accountants released the Exposure Draft *Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits* (IESBA ED), with proposed revisions to the International Code of Ethics for Professional Accountants (the IESBA Code). Paragraph A68 of the proposed SAS noted that “when the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics for Professional Accountants is sufficient to fulfill the component auditor’s ethical responsibilities in the group audit”. As the proposed SAS allows for compliance with the IESBA Code, we recommend the Board to consider the interaction of the IESBA ED and the proposed SAS as it relates to compliance with ethical requirements, including those related to independence, particularly with regard to non-network component auditors involved in a group audit.

For example, the IESBA ED includes provisions requiring individuals participating in the group audit (including those from a non-network component audit firm) to be independent of the group and the group’s related entities (affiliates). The IESBA ED proposes separate independence requirements applicable to non-network component auditor firms. KPMG International has provided responses to the IESBA ED via a separate comment letter that we attached for your reference (particularly our response to question 4 in Appendix A). If the provisions in the IESBA ED are adopted as proposed, the IESBA Code may include different independence requirements from those outlined in the proposed SAS. We recommend the Board to consider such interaction and provide further guidance as necessary to drive consistent application in practice.

- ii. We appreciate the conforming amendments outlined in Appendix C of the Exposure Draft. As *referred-to auditor* is a new term defined in the proposed SAS, we recommend the Board also consider working with the Professional Ethics Executive Committee on conforming



amendments to the AICPA Code of Professional Conduct by incorporating *referred-to auditor* where appropriate (in particular paragraph 0.200.020.03c) when *component auditor* is currently used.