

Discussion Memorandum and Issues: Group Audits

I. Objectives of Agenda Item 2

To discuss a draft of the proposed SAS *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* (proposed SAS) that is based on the draft of International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* that was discussed and approved at the December 2021 International Auditing and Assurance Standards Board's (IAASB) meeting.

II. Members of the Group Audits Task Force

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III Background

In April 2020, the IAASB issued an exposure draft of proposed ISA 600 (Revised) intended to strengthen the auditor's approach to planning and performing a group audit and clarify the interaction of ISA 600 with the other ISAs, including ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*, ISA 315, *Identifying and Assessing the Risks of Material Misstatement*, and ISA 330, *The Auditor's Responses to Assessed Risks*.

The Auditing Standards Board (ASB) has been monitoring the IAASB's discussion of the revisions to extant ISA 600 in preparation for the issuance of an exposure draft (ED) of a proposed SAS that would converge extant AU-C 600 *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* with ISA 600 (Revised). In September 2020, the ASB submitted a comment letter on the ED to the IAASB, and in March, June, September, and December 2021, the ASB and its International Auditing Standards Task Force provided input to the AICPA's IAASB representative on the March, June, September, and December 2021 drafts, respectively. At its December 2021 meeting, the IAASB voted to approve proposed ISA 600 (Revised) as a final standard.

Assuming Responsibility or Making Reference

Extant AU-C 600 provides the group auditor with the following options in a group audit:

- Assume responsibility for, and thus be required to be involved in, the work of a component auditor, insofar as that work relates to the expression of an opinion on the group financial statements, (i.e., "assume responsibility")
- Not assume responsibility for, and accordingly make reference to, the audit of a component auditor in the auditor's report on the group financial statements (i.e., "make reference")

At its June 2021 meeting, the ASB agreed to retain these options in the proposed SAS. ISA 600 (Revised), like its predecessor, does not include an option for the group engagement partner to make reference because this is not allowed under the ISAs.

ASB Conclusions at the October 2021 Meeting

At its October 2021 meeting, Dora Burzenski, Chair of the ASB's Group Audits Task Force (Task Force) and a correspondent member of the IAASB's ISA 600 Task Force, led the ASB in a discussion of a draft of the proposed SAS that was based on the September 2021 IAASB draft of proposed ISA 600 (Revised), with the following substantive changes:

1. The addition of the making reference paragraphs from extant AU-C 600
2. Determined whether the paragraphs in the October 2021 draft of proposed ISA 600 (Revised) were applicable (1) when assuming responsibility and when making reference (2) only when assuming responsibility, or (3) only when making reference. We then revised the language in those paragraphs or added text to reflect such determination.
3. For the requirement paragraphs that are applicable only when assuming responsibility or only when making reference, an indication that the requirement is applicable only when assuming responsibility or only when making reference

After discussing the draft, the ASB concluded that certain requirements that would be achieved by assuming responsibility did not always appear to be achievable when making reference, for example, requirements that address involvement by the group auditor in the work of component auditors. To address this issue the ASB recommended the following:

- Develop a separate proposed SAS that would be applicable only when the group auditor is making reference, to make it clear that the requirements applicable when making reference generally differ from the requirements that are applicable when the group auditor is assuming responsibility. This proposed SAS was preliminarily designated the “proposed making reference [MR] SAS”.
- Introduce the term *referred-to auditor* in the proposed MR SAS and define it to mean an auditor of a component's financial statements other than the group auditor and the component auditor, who performs an audit of the financial statements of a component and issues an auditor's report in accordance with GAAS to which the group auditor makes reference in the group auditor's report.
- Revise the definition of the term *component auditor* in the proposed group audits (GA) SAS (i.e., proposed SAS *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*) to include only those auditors that the group auditor is assuming responsibility for. In the proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS) the definition of the term *engagement team* includes component auditors. Because under the proposed SAS referred-to auditors would no longer be component auditors, the term *engagement team* would not include referred-to auditors, and the definition of the term *engagement team* in the proposed QM SAS would not need to be changed.
- In the proposed GA SAS, refer the group auditor to the proposed MR SAS when the group auditor is making reference.

January 2021 Draft of the Proposed SAS

After much deliberation and consideration concerning how to achieve the objectives stated by the ASB at its October meeting, the Task Force decided to take a slightly different approach than the one recommended by the ASB (i.e., developing a separate MR SAS) and instead included all the paragraphs

related to making reference (except for a very few) together in one section within a single proposed SAS, located towards the end of the SAS. The Task Force believes that this approach

- accomplishes the objective of the ASB;
- enables the Task Force to avoid making pervasive changes to ISA 600 (Revised) to accommodate text related to referred-to auditors because the making reference paragraphs are located in a separate section towards the end of the proposed SAS rather than being interspersed throughout the document;
- eliminates the potential confusion that might exist concerning which SAS applies in which circumstance; and
- results in a streamlined and easy to follow standard, both when assuming responsibility and also when making reference.

In the January 2021 draft of the proposed SAS, the Task Force has added the paragraphs on making reference from extant AU-C 600 (modified as little as possible, so as to preserve extant AU-C 600). It is no longer necessary to indicate pervasively throughout the proposed SAS whether a requirement is applicable only when assuming responsibility or only when making reference, because the change to the definition of *component auditor* in the proposed SAS carves referred-to auditors out of the definition of component auditors. The only other changes that have been made to ISA 600 (Revised) are the following:

- Changes to reflect differences that currently exist between extant AU-C 600 and extant ISA 600, unrelated to making reference
- If needed, changes to the requirements to reflect the uniqueness of the US environment
- If needed, the addition or deletion of application material to reflect the uniqueness of the US environment
- Changes to reflect ASB drafting conventions (e.g., replacing shall with should)
- Limited, minor editorial changes.

The objective of the Task Force is to develop an exposure draft of a proposed SAS that the ASB will be able to vote on at its March 2022 meeting, and then issue for exposure. With that in mind, Ms. Burzenski, will lead the ASB in a paragraph-by-paragraph review of the requirements of the proposed SAS (Agenda Item 2A), with discussion of the application material as needed.

IV Agenda Materials

Agenda Item 2	Discussion Memorandum and Issues: Group Audits
Agenda Item 2A	<i>Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)</i> Marked from Final ISA 600 (Revised)
Agenda Item 2B	A clean draft of the proposed SAS
Agenda Item 2C	Final ISA 600 (Revised) Marked from the September 2021 IAASB Draft of proposed ISA 600 (Revised).
Agenda Item 2D	Amendments to Various Statements on Auditing Standards (SAs) to Reflect <i>Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)</i>

Issues Related to the Proposed Group Audits SAS

1. Replacing “Assuming Responsibility” With “Taking Responsibility”?

Extant AU-C section 600 uses the phrase “assuming responsibility” for the work of component auditors. ISA 600 (Revised) uses the phrase “taking responsibility,” however the phrase “taking responsibility” is used in a different context that does not relate to decisions to make or not to make reference. A question was raised by the Task Force regarding whether assuming responsibility for audit work performed by component auditors is the same as taking responsibility for that work, and whether the phrase “assuming responsibility,” which is used in extant AU-C 600 and was initially carried over into the proposed SAS should be replaced with “taking responsibility”.

Upon consideration of this question, the Task Force believes there is a distinction between the two phrases, in that taking responsibility is used in the context of assigning the design or performance of more specific procedures, tasks, or actions to component auditors (such as performing risk assessment procedures) and that assuming responsibility, as used in extant AU-C 600, is a broader concept representing responsibility for the work performed by component auditors in totality.

Paragraph 11 of the proposed SAS states in part,

...The term “the group engagement partner should take responsibility for...” or “the group auditor should take responsibility for...” is used for those requirements when the group engagement partner or group auditor, respectively, is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled by the group engagement partner or group auditor, as applicable, and the group engagement partner or group auditor may obtain information from the firm or other members of the engagement team.

Paragraph 11 indicates that “should take responsibility for” means that the group auditor is permitted to assign procedures to someone else. Although extant AU-C 600 does not use the phrase “should take responsibility for,” the same concept is embedded in paragraph 10 of extant AU-C 600 shown below:

.10 The engagement partner should take responsibility for the overall quality on each audit engagement to which that partner is assigned. In fulfilling this responsibility, the engagement partner may delegate the performance of certain procedures to, and use the work of, other members of the engagement team and may rely upon the firm's system of quality control.

Because “assuming responsibility” does not mean the same thing as “taking responsibility,” the two phrases are not interchangeable.

It is important to note that because ISA 600 (Revised) does not allow the group engagement partner to make reference, it does not need the term “assuming responsibility,” which is used in extant AU-C 600 when describing the two options available to the group auditor (assuming responsibility or making reference).

The Task Force ultimately decided

- not to replace the phrase “assume responsibility” with the phrase “take responsibility.”
- not to use the phrase “assume responsibility” in the proposed SAS to avoid any potential confusion between the meaning of “assuming responsibility” and “taking responsibility” (given that some view the words as having the same meaning).

- use different language to describe and refer to the “assuming responsibility option” such as “being involved in the work of component auditors” or “when component auditors are involved.”
- that the requirements related to the concept of “assuming responsibility” (as used in extant) versus making reference are clear in the proposed SAS, through using the terms component auditor and referred-to auditor, respectively.

The following is an example of how the initial draft of the proposed SAS developed by the Task Force was revised to eliminate the phrase “assume responsibility.”

50.5.1 If the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless

...

- b. the group engagement team has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to ~~assume responsibility for, and, thus, be involved in the work of the referred-to auditor.~~

Such language is consistent with the language in ISA 600 (Revised) that implies that the group auditor is ultimately responsible for the work of the component auditors.

Therefore, the two options in the proposed SAS are worded as follows:

- Making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements
- Being involved in the work of the component auditors.

Questions for the ASB

1. Is use of language such as “when component auditors are involved” or “when the group engagement partner is involved in the work of component auditors” appropriate?

2. Members of the Engagement Team

Paragraph 12 of the proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS) contains the following definition:

Engagement team. All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, excluding an auditor's external specialist⁵ and internal auditors who provide direct assistance on an engagement.⁶

⁵ Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

⁶ AU-C section 610, *Using the Work of Internal Auditors*, establishes limits on the use of direct assistance.

Paragraph 14 of the proposed SAS contains the following definitions:

- c **Component auditor.** An auditor who performs audit work related to a component for purposes of

the group audit. A component auditor is a part of the engagement team¹ for a group audit.

- h* **Group auditor.** The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for:

- i Establishing the overall group audit strategy and group audit plan;
- ii Directing and supervising component auditors and reviewing their work;
- iii Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements.

- m1 Referred-to auditor.* An auditor who performs an audit of the financial statements of a component to which the group engagement partner makes reference in the auditor's report on the group financial statements.

A26.1 A referred-to auditor is not a component auditor, and accordingly is not part of the engagement team. Therefore, the requirements in this proposed SAS with respect to the engagement team are not applicable to referred-to auditors.

Based on these definitions and paragraph A26.1, a component auditor is part of the engagement team, but a referred-to auditor is not part of the engagement team. Why is that the case?

The group auditor is responsible for directing and supervising component auditors and reviewing their work, and such work is performed for purposes of the group audit (i.e., being involved in the work of the component auditor). In contrast, referred-to auditors do not perform audit procedures specifically for the group audit engagement, and instead, the group auditor makes reference to the referred-to auditor's audit report.

Component auditors are included in the definition of engagement team and are subject to the quality management procedures required of the engagement partner by the proposed QM SAS; referred to auditors are not included in the definition of engagement team.

Referred-to auditors are neither part of the engagement team designation nor part of the component auditor designation, but in order for the group engagement partner to achieve quality in the group audit, it is necessary for the group engagement partner to perform procedures that address, for example, competency of the referred-to auditors. That is achieved within the proposed SAS by establishing separate requirements for the group engagement partner regarding referred-to auditors (consistent with the requirements in extant AU-C 600), such as the following:

50.2 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for:

- (a) Determining that referred-to auditors have the appropriate competence and capabilities; and
- ...

The Task Force believes that this approach covers all the parties that contribute audit evidence to the group audit that could potentially affect the quality of the group audit (the group auditor, component auditors, and referred-to auditors).

Questions for the ASB

1. Does the ASB believe that this model will result in a group audit that achieves the objectives of the proposed QM SAS?
2. Is the model understandable?

¹ Paragraph 12 of proposed QM SAS

3. Should the proposed QM SAS echo some of the clarifications included in the proposed SAS, such as the following:
 - A component auditor is part of the engagement team.
 - A referred-to auditor is not a component auditor, and accordingly is not part of the engagement team.
4. Should the following application paragraph be added to the proposed QM SAS, linked to the definition of the term “engagement team.”

In the definition of the term *engagement team* in paragraph 12, the word “engagement” in the phrase “and any other individuals who perform audit procedures on the engagement” means the audit of the group financial statements. It does not include the audit of a component’s financial statements performed by a referred-to auditor; therefore, a referred-to auditor is not part of the engagement team.

3. Referred-to Auditor Requirements

The proposed SAS includes the majority of the making reference paragraphs in one section of a single proposed SAS, towards the end of the document (paragraphs 50.1-50.13). The first mention of referred-to auditors is in the requirements section of the proposed SAS under the heading “Acceptance and Continuance” (paragraphs 17 and 17.1).

17. Before accepting or continuing the group audit engagement, the group engagement partner should determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained, including through making reference to the audit of a referred-to auditor in the auditor’s report, to provide a basis for forming an opinion on the group financial statements.

17.1 When the group engagement partner plans to obtain audit evidence through making reference to the audit of a referred-to auditor, the group engagement partner should apply the specific requirements in paragraphs 50.1-50.13.

Questions for the ASB

1. Are the specific requirements related to referred-to auditors easily identifiable within the proposed SAS?
2. Could the language within paragraphs 17 and 17.1 of the proposed SAS inappropriately be interpreted to mean that when the group engagement partner plans to make reference to the audit of a referred-to auditor, **only** paragraphs 50.1-50.13 of the proposed SAS are applicable?

4. PCAOB Group Audits Project

It is worth noting that the PCAOB currently has a project underway to amend existing auditing standards related to audits of group financial statements. On September 28, 2021, the PCAOB issued [Release 2021-005](#) which requested comments on proposed amendments to its auditing standards related to the supervision of audits that involve accounting firms and individual accountants outside the accounting firm

that issue the auditor's report. This release was a second supplemental request for comment on amendments that were first included in a 2016 proposing release and subsequently revised in a 2017 supplemental request for comment. The Task Force evaluated differences between the PCAOB proposed amendments and this proposed SAS. This proposed SAS

- contains all requirements with respect to group audits in one standard (i.e., from acceptance and continuance to concluding and reporting);
- expands on the application of other relevant AU-C sections by addressing the special considerations that apply to a group audit.

In comparison, the PCAOB has several disaggregated standards that address requirements with respect to group audits; therefore, the proposed amendments address several standards. The following are the proposed amendments:

- Rescind AS 1205, *Part of the Audit Performed by Other Independent Auditors*, and clarify that the lead auditor would be required to (i) when assuming responsibility for the other auditors' work, supervise the other auditor under AS 1201, *Supervision of the Audit Engagement* and (ii) when dividing responsibility for the audit with a referred-to auditor, comply with proposed AS 1206, *Dividing Responsibility for the Audit With Another Accounting Firm*."
- Amend AS 1201, *Supervision of the Audit Engagement*, to provide additional direction to the lead auditor on how to apply the principles-based provisions of the standard to the supervision of other auditors.
- Amend AS 2101, *Audit Planning*, to incorporate and update certain requirements from AS 1205, and amend certain existing requirements to specify that they be performed by the lead auditor.
- Adopt a new standard, AS 1206, *Dividing Responsibility for the Audit With Another Accounting Firm*. The new standard would retain, with modifications, many of the current requirements in AS 1205 that apply when the lead auditor divides responsibility with the referred-to auditor and refers to its report in the lead auditor's report but also would establish certain new requirements."

The PCAOB proposed amendments focus on the "audit planning" and "supervision" phases of the group audit when "other auditors" (akin to component auditors in the proposed SAS) are involved. The PCAOB maintains separate standards on identifying and assessing risks of material misstatement (AS 2110), audit documentation (AS 1215), subsequent events (AS 2801), among others, to which the PCAOB did not propose amendments unless through minor conforming or consequential amendments (in other words, these standards do not specifically address how they are applied in a group audit). However, such topics are addressed within the proposed SAS as they relate to group audits (and were also addressed in extant AU-C 600). This is worth noting, as the approach the PCAOB has taken to their standards differs from the AICPA and ISA. Furthermore, the PCAOB proposed amendments contain a separate standard related to referred-to auditors (AS 1206), whereas the proposed SAS contains all requirements related to referred-to auditors. Although the Task Force gave consideration to the PCAOB proposed amendments, the Task Force decided to draft the proposed SAS based on ISA 600 (Revised) in accordance with the AICPA's policy to converge with the ISAs and with support from the ASB on this approach. Additionally, the PCAOB's proposed amendments are not final, and there is no indication as to when they may be effective.