



**AUDITING STANDARDS BOARD MEETING AGENDA**  
**January 25-27, 2022**  
**VideoConference (Zoom)**  
**(Times are EST)**

Tuesday, January 25 11:00am – 5:30pm	Wednesday, January 26 11:00am – 5:30pm	Thursday, January 27 10:30am – 5:30pm
<p>11:00–12:00 <b>Agenda Item 1</b>      <b>Chair/AICPA/IAASB Update</b></p> <p>12:00–1:00 <b>Agenda Item 2</b>      <b>Group Audits Draft Document</b></p> <p>1:00–1:30                      <i>Break</i></p> <p>1:30–3:30 <b>Agenda Item 2</b>      <b>Group Audits Draft Document</b></p> <p>3:30–4:00                      <i>Break</i></p> <p>4:00–5:30 <b>Agenda Item 3</b>      <b>AU-C 935 Exposure Draft</b></p>	<p>11:00–1:00 <b>Agenda Item 4</b>      <b>Quality Management Draft Document</b></p> <p>1:00–2:00                      <i>Break</i></p> <p>2:00–4:00 <b>Agenda Item 4</b>      <b>Quality Management Draft Document</b></p> <p>4:00–4:30                      <i>Break</i></p> <p>4:30–5:30 <b>Agenda Item 5</b>      <b>Executive Session</b></p>	<p>10:30–12:30 <b>Agenda Item 2</b>      <b>Group Audits Draft Document</b></p> <p>12:30–1:00                      <i>Break</i></p> <p>1:00–1:30 <b>Agenda Item 3</b>      <b>AU-C 935 Vote to Expose</b></p> <p>1:30–3:30 <b>Agenda Item 5</b>      <b>Executive Session (Continued)</b></p> <p>3:30–4:00                      <i>Break</i></p> <p>4:00–5:30 <b>Agenda Item 5</b>      <b>Executive Session (Continued)</b></p>



# IAASB Update

Wendy Stevens, Mazars  
IAASB Member

*Presentation at the January 2022 ASB Meeting*

## Key Items

- December 2021 IAASB Meeting Highlights
    - Matters approved
      - ISA 600
      - 2022-2023 workplan
      - Fraud project proposal
- 



# Summary of IAASB Significant Projects\*

Topic	Status	Main Objective
<b>Audits of LCEs</b>	Comment letters due January 31, 2022	Develop a separate standard for financial statement audits of LCEs to address issues and challenges related to complexity, understandability, scalability and proportionality
<b>Group Audits</b>	Awaiting PIOB approval (expected 1 <sup>st</sup> half of 2022)	Revised Extant ISA 600 to: <ol style="list-style-type: none"> <li>1) strengthen approach to planning and performance of a group audit</li> <li>2) clarify interaction with other ISAs</li> <li>3) The revised standard will be effective for periods beginning on or after December 15, 2023</li> </ol>
<b>Audit Evidence</b>	Working toward ED in September of 2022	Exposure draft timing change: March 2022 to September 2022; Focus is to modernize for IT, address the sufficiency and appropriateness of audit evidence and improve professional skepticism
<b>Definition of Listed Entities and PIEs</b>	ED planned 2022	Develop and finalize narrow-scope amendments for changes made by IESBA in its project to achieve convergence as much as possible
<b>CUSP</b>	Recommendations March 2022	Address the complexity, understandability, scalability, and proportionality of the ISAs by developing drafting principles and guidelines
<b>Fraud</b>	March 2022 agenda item, ED planned for June 2023	Approved in December 2021, the project is expected to addresses the revision of extant ISA 240 and the conforming and consequential amendments to other relevant ISAs to enhance or clarify the auditor's responsibilities on fraud in an audit of financial statements
<b>Going Concern</b>	Project Proposal Targeted for March 2022 IAASB approval	Project proposal expected to address revisions to extant ISA 570 to enhance or clarify the auditor's work related to management's assessment of an entity's ability to continue as a going concern in the audit of financial statements and enhance transparency

\*As of January 25, 2022

## Work Plan 2022-2023

- Unanimously approved in December 2021
  - Key planned actions for projects underway
    - Planned 2022 exposure drafts: Audit Evidence, Going Concern, and the Definition of Listed and Public Interest Entities
    - CSUP drafting principles and guidelines targeted for 2022
  - One or two new projects expected to commence during the Work Plan period
    - The IAASB agreed to dedicate capacity and resources to the assurance of sustainability/ESG reporting
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## Audits of Less Complex Entities

- July 23, 2021 - IAASB issued the exposure draft of the proposed ISA for LCEs
    - Intended to address the challenges of applying the ISAs in audits of LCEs and to address CUSP in the ISAs
    - IAASB issued documents that illustrate how requirements from the ISAs map to the Exposure Draft
    - IAASB consultation survey closed January 14, 2022
    - Comments are due January 31, 2022
- 



## Group Audits

- The IAASB unanimously approved ISA 600 (Revised) as a final standard
    - The IAASB will formally release the standard after confirmation is received from the PIOB that due process was followed
    - The revised standard will be effective for periods beginning on or after December 15, 2023
  - In finalizing the standard, the IAASB clarified scope, enhanced certain procedures, and improved auditor communication requirements
- 



# Fraud

- The project will be focused on specific standard-setting actions aimed at enabling consistent and improved auditor behavior
    - The project will seek to clarify the auditor's responsibilities and enhance the robustness of the required auditor's procedures and reporting on fraud in an audit of financial statements
  - March 2022 IAASB meeting
    - Focus on specific proposed actions included in the scope of the project addressing key issues identified regarding the role and responsibilities of the auditor, risk identification and assessment, and transparency
  - Expected exposure draft: June 2023
- 



## Going Concern

- Anticipated project proposal:
    - Similar in structure to the Fraud project proposal
    - Objectives, in addition to strengthening the auditor work and transparency, may also include more robust linkage to risk identification and assessment procedures
    - Continued dialogue with others in the financial reporting ecosystem expected, including the IASB
  - Project proposal to be brought to IAASB in March 2022
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## Other Major Projects

- Audit Evidence
  - CUSP
  - Definition of Listed Entity and Public Interest Entities (PIE)
    - In December 2021 IESBA unanimously approved revisions to the definitions of “listed entity” and “public interest entity” (awaiting PIOB approval)
    - The IAASB PIE Working Group will present a project proposal for discussion and approval at the March 2022 IAASB meeting
- 



## Other Activities

- Conforming Amendments to QM Standards
    - Released in January 2022 and become effective as of December 15, 2022
  - Two new board member appointments; 3 renewed (November 2021)
  - First Digital Handbook Published (December 2021)
  - FAQ: using automated tools and techniques when planning the audit (December 2021)
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# Thank you

## 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

Dora Burzenski, Chair; assisted by Lauren Kolarik  
Mike Bingham  
Monique Booker  
Harry Cohen  
Heather Funsch  
Clay Huffman  
Maria Manasses  
Staffed by Judith Sherinsky

### 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	Proposed SAS <i>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 (SASs) to Reflect Proposed SAS <i>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 specialist<sup>5</sup> and internal auditors who provide direct assistance on an engagement.<sup>6</sup>

<sup>5</sup> Paragraph .06 of AU-C section 620, *Using the Work of an Auditor’s Specialist*, defines the term *auditor’s specialist*.

<sup>6</sup> 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 team<sup>1</sup> 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?

<sup>1</sup> 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.

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

(Marked from ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (Approved December 2021))

## Introduction

### Scope of this **Proposed SAS**

1. Generally accepted auditing standards (GAAS)~~The International Standards on Auditing (ISAs)~~ apply to an audit of group financial statements (a group audit). This proposed Statement on Auditing Standards (SAS)~~ISA~~ addresses deals with special considerations that apply to a group audit, including in those circumstances when component auditors are involved or when the group auditor makes reference to the audit of a referred-to auditor. The requirements and guidance in this proposed SAS ~~ISA~~ refer to, or expand on, the application of other relevant AU-C sections~~ISAs~~ to a group audit, in particular ~~ISA 220 (Revised)~~ proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (proposed QM SAS),<sup>1</sup> AU-C section ~~ISA~~ 230, Audit Documentation,<sup>2</sup> AU-C section ~~ISA~~ 300, Planning an Audit,<sup>3</sup> AU-C section 315, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment ~~ISA 315 (Revised 2019)~~,<sup>4</sup> and AU-C section ~~ISA~~ 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained.<sup>5</sup> (Ref: Para. A1–A2)
2. Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph 14(k). The term consolidation process as used in this proposed SAS ~~ISA~~ refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions. (Ref: Para. A3–A5, A25)
- 2.1. Government entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide, State and Local Governments provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.
3. As explained in proposed QM SAS ~~ISA 220 (Revised)~~,<sup>6</sup> this proposed SAS~~ISA~~, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this proposed SAS~~ISA~~ may be useful when involving such an individual to attend a physical inventory count, inspect property, plant, and equipment, or perform audit procedures at a shared service center at a remote

<sup>1</sup> Proposed QM SAS ~~ISA 220 (Revised)~~, Quality Management for an ~~Audit of Financial Statements~~ Engagement Performed in Accordance with Generally Accepted Auditing Standards

<sup>2</sup> AU-C section ~~ISA~~ 230, Audit Documentation

<sup>3</sup> AU-C section ~~ISA~~ 300, Planning an Audit of Financial Statements

<sup>4</sup> SAS No. 145~~ISA 315 (Revised 2019)~~, Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment

<sup>5</sup> AU-C section ~~ISA~~ 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained ~~The Auditor's Responses to Assessed Risks~~

<sup>6</sup> Paragraph A1 of proposed QM SAS~~ISA 220 (Revised)~~, paragraph A1

location.

#### *Groups and Components*

4. A group may be organized in various ways. For example, a group may be organized by legal or other entities (e.g., a parent and one or more subsidiaries, joint ventures, or investments accounted for by the equity method). Alternatively, the group may be organized by geography, by other economic units (including branches or divisions), or by functions or business activities. In this proposed SAS, these different forms of organization are collectively referred to as “entities or business units.” (Ref: Para. A6)
5. The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, the group auditor uses professional judgment in determining the components at which audit work will be performed. This determination is based on the group auditor’s understanding of the group and its environment, and other factors such as the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and internal control. (Ref: Para. A7–A9)

#### *Involvement of Component Auditors*

6. Proposed QM SAS ISA-220 (Revised)<sup>7</sup> requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. In a group audit, such resources may include component auditors. Therefore, this proposed SAS requires the group auditor to determine the nature, timing, and extent of involvement of component auditors.
7. The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this proposed SAS. Component auditors may have greater experience with, and a more in-depth knowledge of, the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit. (Ref: Para. A10–A10A)
8. Audit risk is a function of the risks of material misstatement and detection risk.<sup>8</sup> Detection risk in a group audit includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this proposed SAS requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this proposed SAS explains the matters that the group auditor takes into account when determining the nature, timing and extent of the direction and supervision of component auditors and the review of their work. (Ref: Para. A11–A12)

#### *Making Reference to the Audit of a Referred-To Auditor*

##### 8.1 This proposed SAS also describes the procedures to be followed to obtain sufficient appropriate audit

<sup>7</sup> Paragraph 25 of proposed QM SAS ISA-220 (Revised), paragraph 25

<sup>8</sup> Paragraph –A38 of AU-C section ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing, paragraph A34

evidence when the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor communicates the source of audit evidence with respect to those components for which such reference is made. When component auditors are involved, no reference is made to the component auditor in the auditor's report on the group financial statements.

#### *Professional Skepticism*

9. In accordance with AU-C section ISA 200,<sup>9</sup> the engagement team is required to plan and perform the group audit with professional skepticism and to exercise professional judgment. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement team, including emphasizing the importance of each engagement team member exercising professional skepticism throughout the group audit. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate exercise of professional skepticism. (Ref: Para. A13–A17)

#### *Scalability*

10. This proposed SAS is intended for all group audits, regardless of size or complexity. However, the requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each group audit. For example, when a group audit is carried out entirely by the group auditor, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of component auditors. This may be the case when the group auditor is able to perform audit procedures centrally or is able to perform procedures at the components without involving component auditors. The guidance in paragraphs A117 and A118 also may be helpful in applying this proposed SAS in these circumstances.

#### *Responsibilities of the Group Engagement Partner and Group Auditor*

11. The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this proposed SAS. The term “the group engagement partner ~~shall-should~~ take responsibility for...” or “the group auditor ~~shall-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. (Ref: Para. A17.1-A17.3, A27)

#### **Effective Date**

12. This proposed SAS is effective for audits of group financial statements for periods beginning on or after December 15, 2025~~23~~.

#### **Objectives**

13. The objectives of the auditor are to:
- (a) With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to

<sup>9</sup> Paragraphs 17-18 and A24-A28 of AU-C section ISA 200, ~~paragraphs 15–16~~

provide a basis for forming an opinion on the group financial statements;

- (a.1) Determine whether to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements-, and if so, report in accordance with this proposed SAS;
- (b) Identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately respond to those assessed risks;
  - (c) Be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and evaluating the results of that work; and
  - (d) Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, as a basis for forming an opinion on the group financial statements.

## Definitions

14. For purposes of ~~the GAAS-ISAs~~, the following terms have the meanings attributed ~~below~~as follows:
- (a) Aggregation risk – The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. (Ref: Para. A18)
  - (b) Component – An entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit. (Ref: Para. A19-A19.1)
  - (c) Component auditor – An auditor who performs audit work related to a component for purposes of the group audit ~~for which the group auditor assumes responsibility~~. A component auditor is a part of the engagement team<sup>10</sup> for a group audit. (Ref: Para. A20–A21A)
  - (d) Component management – Management responsible for a component. (Ref: Para. A22)
  - (e) Component performance materiality – An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.
  - (f) Group – A reporting entity for which group financial statements are prepared.
  - (g) Group audit – The audit of group financial statements.
  - (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.
  - (i) Group audit opinion – The audit opinion on the group financial statements.

<sup>10</sup> Paragraph 12 of proposed QM SAS ISA 220 (Revised), paragraph 12(d)

- (j) Group engagement partner – The engagement partner<sup>11</sup> who is responsible for the group audit. (Ref: Para. A23)
- (k) Group financial statements – Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this proposed SASISA, a consolidation process includes the following: (Ref: Para. A24–A26)
  - (i) Consolidation, proportionate consolidation, inclusion, or an equity method of accounting;
  - (ii) The presentation in combined financial statements of the financial information of entities or business units that ~~have no parent but~~ are under common control or common management; or
  - (iii) The aggregation of the financial information of entities or business units such as branches or divisions.
- (l) Group management – Management responsible for the preparation of the group financial statements.
- (m) Group performance materiality – Performance materiality<sup>12</sup> in relation to the group financial statements as a whole, as determined by the group auditor.
 

(m.1) 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. (Ref: Para. A26.1)

15. Reference in this proposed SASISA to “the applicable financial reporting framework” means the financial reporting framework that applies to the group financial statements. (Ref: Para. A26.2)

## Requirements

### Leadership Responsibilities for Managing and Achieving Quality on a Group Audit

16. In applying proposed QM SAS ISA 220 (Revised),<sup>13</sup> the group engagement partner is required to take overall responsibility for managing and achieving quality on the group audit engagement. In doing so, the group engagement partner ~~shall~~should: (Ref: Para. A27–A28)
- (a) Take responsibility for creating an environment for the group audit engagement that emphasizes the expected behavior of engagement team members. (Ref: Para. A29)
  - (b) Be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement.

### Acceptance and Continuance

17. Before accepting or continuing the group audit engagement, the group engagement partner ~~shall~~ 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. (Ref: Para. A30–

<sup>11</sup> Paragraph 12 of proposed QM SAS ISA 220 (Revised), paragraph 12(a)

<sup>12</sup> Paragraphs -9 and 11 of AU-C section-ISA 320, *Materiality in Planning and Performing an Audit*, paragraphs 9 and 11

<sup>13</sup> Paragraph 13 of proposed QM SAS ISA 220 (Revised), paragraph 13

A33.2)

17.1 When the group engagement partner plans to obtain audit evidence through ~~determines to 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 (Ref: Para. A33.1-A33.2)

18. If, after the acceptance or continuance of the group audit engagement, the group engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the group engagement partner ~~shall~~should consider the possible effects on the group audit. (Ref: Para. A34)

*Terms of the Engagement*

19. In applying ~~AU-C section ISA~~ 210, *Terms of Engagement*<sup>14</sup> the group auditor ~~shall~~should obtain the agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with: (Ref: Para. A35)

- (a) Access to all information of which group management is aware that is relevant to the preparation of the group financial statements such as records, documentation, and other matters;
- (b) Additional information that the engagement team may request from group management or component management for the purpose of the group audit; and
- (c) Unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence.

*Restrictions on Access to Information or People Outside the Control of Group Management*

20. 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~~should consider the possible effects on the group audit. (Ref: Para. A36–A43)

*Restrictions on Access to Information or People Imposed by Group Management*

21. If the group engagement partner concludes that: (Ref: Para. A41–A43)

- (a) It will not be possible for the group auditor 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~~should either:

- (i) In the case of an initial engagement, not accept the engagement, or, in the case of a recurring engagement, withdraw from the engagement, when withdrawal is possible under applicable law or regulation; or
- (ii) When the entity is required by law or regulation ~~prohibit to have an audit auditor from declining an engagement or when 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.

<sup>14</sup> Paragraphs 6(b) and 8-(b) of AU-C section ISA 210, *Agreeing the Terms of Audit Engagements*, paragraphs 6(b) and 8(b)

### Overall Group Audit Strategy and Group Audit Plan

22. In applying AU-C section ISA 300,<sup>15</sup> the group auditor ~~shall~~should establish, and update as necessary, an overall group audit strategy and group audit plan. In doing so, the group auditor shall determine: (Ref: Para. A44–A47)
- (a) The components at which audit work will be performed; ~~and~~ (Ref: Para. A48)
  - (b) The resources needed to perform the group audit engagement, including the nature, timing and extent to which component auditors are to be involved; and- (Ref: Para. A49–A53)
  - (b.1) The components for which, if any, the auditor’s report on the group financial statements will make reference to the audit of a referred-to auditor, as discussed in paragraphs 50.1-50.13.

### Considerations When Component Auditors Are Involved

23. In establishing the overall group audit strategy and group audit plan, the group engagement partner ~~shall~~should evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor. (Ref: Para. A54)
24. As part of the evaluation in paragraph 23, the group auditor ~~shall~~should request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. (Ref: Para. A55)

### Relevant Ethical Requirements, Including Those Related to Independence

25. In applying proposed QM SAS ISA 220 (Revised),<sup>16</sup> the group engagement partner ~~shall~~should take responsibility for: (Ref: Para. A56–A57, A84)
- (a) Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and
  - (b) Confirming whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.

### Engagement Resources

26. In applying proposed QM SAS ISA 220 (Revised),<sup>17</sup> the group engagement partner ~~should~~shall: (Ref: Para. A58–A65)
- (a) Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component; and
  - (b) If information about the results of the monitoring and remediation process or external inspections related to the component auditor has been provided by the group auditor’s firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor’s determination in paragraph 26(a).
27. The group auditor ~~shall~~should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor if:

<sup>15</sup> Paragraphs 7-10 of AU-C section ISA 300, paragraphs 7–10A

<sup>16</sup> Paragraph 17 of proposed QM SAS ISA 220 (Revised), paragraph 17

<sup>17</sup> Paragraphs 25-26 of proposed QM SAS ISA 220 (Revised), paragraphs 25–26

- (a) The component auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement,<sup>18</sup> or (Ref: Para. A66–A67)
- (b) The group engagement partner has serious concerns about the matters in paragraphs 23–26. (Ref: Para. A68)

#### Engagement Performance

28. In applying ~~proposed QM SAS ISA 220 (Revised)~~,<sup>19</sup> the group engagement partner ~~shall~~should take responsibility for the nature, timing and extent of direction and supervision of component auditors and the review of their work, taking into account: (Ref: Para. A69–A74)

- (a) Areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with ~~AU-C section 315 ISA 315 (Revised 2019)~~; and
- (b) Areas in the audit of the group financial statements that involve significant judgment.

#### Communications with Component Auditors

29. The group auditor ~~shall~~should communicate with component auditors about their respective responsibilities and the group auditor's expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit. (Ref: Para. A75–A84)

#### Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control

30. In applying ~~AU-C section 315 ISA 315 (Revised 2019)~~,<sup>20</sup> the group auditor ~~shall~~should take responsibility for obtaining an understanding of the following: (Ref: Para. A85–A89)

- (a) The group and its environment, including: (Ref: Para. A90–A92)
  - (i) The group's organizational structure and its business model, including:
    - a. The locations in which the group has its operations or activities;
    - b. The nature of the group's operations or activities and the extent to which they are similar across the group; and
    - c. The extent to which the group's business model integrates the use of IT;
  - (ii) Regulatory factors impacting the entities and business units in the group; and
  - (iii) The measures used internally and externally to assess the entities or business units' financial performance;
- (b) The applicable financial reporting framework and the consistency of accounting policies and practices across the group; and
- (c) The group's system of internal control, including:
  - (i) The nature and extent of commonality of controls; (Ref: Para. A93–A97, A100)

<sup>18</sup> ~~Paragraph 16 of AU-C section ISA 200, paragraph 14~~

<sup>19</sup> ~~Paragraph 29 of proposed QM SAS ISA 220 (Revised), paragraph 29~~

<sup>20</sup> ~~Paragraphs 19-31 of AU-C section 315 ISA 315 (Revised 2019), paragraphs 19–27~~

- (ii) Whether, and if so, how, the group centralizes activities relevant to financial reporting; (Ref: Para. A98–A100)
- (iii) The consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments; and
- (iv) How group management communicates significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group’s system of internal control to management of entities or business units. (Ref: Para. A101–A103)

*Considerations When Component Auditors Are Involved*

31. The group auditor ~~shall~~should communicate to component auditors on a timely basis: (Ref: Para. A104)
- (a) Matters that the group auditor determines to be relevant to the component auditor’s design or performance of risk assessment procedures for purposes of the group audit, including identified significant risks of material misstatement of the group financial statements;
  - (b) In applying ~~AU-C section-ISA~~ 550,<sup>21</sup> related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor; and (Ref: Para. A105)
  - (c) In applying ~~AU-C section-ISA~~ 570 (Revised),<sup>22</sup> events or conditions identified by group management or the group auditor, that may cast significant doubt on the group’s ability to continue as a going concern that are relevant to the work of the component auditor.
32. The group auditor ~~shall~~should request component auditors to communicate on a timely basis:
- (a) Matters related to the financial information of the component that the component auditor determines to be relevant to the identification and assessment of the risks of material misstatement of the group financial statements, whether due to fraud or error;
  - (b) Related party relationships not previously identified by group management or the group auditor; and
  - (c) Any events or conditions identified by the component auditor that may cast significant doubt on the group’s ability to continue as a going concern.

**Identifying and Assessing the Risks of Material Misstatement**

33. In applying ~~AU-C section 315ISA 315 (Revised 2019)~~,<sup>23</sup> based on the understanding obtained in paragraph 30, the group auditor ~~shall~~should take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements, including with respect to the consolidation process. (Ref: Para. A106–A111)

*Considerations When Component Auditors Are Involved*

34. In applying ~~AU-C section 315ISA 315 (Revised 2019)~~,<sup>24</sup> the group auditor ~~shall~~should evaluate

<sup>21</sup> ~~Paragraph 19 of AU-C section-ISA 550, Related Parties, paragraph 17~~

<sup>22</sup> ~~AU-C section-ISA 570 (Revised), The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern~~

<sup>23</sup> ~~Paragraphs 32-38 of AU-C section 315ISA 315 (Revised 2019), paragraphs 28–34~~

<sup>24</sup> ~~Paragraph 39 of AU-C section 315ISA 315 (Revised 2019), paragraph 35~~

whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements. (Ref: Para. A112–A113)

### Materiality

35. In applying ~~AU-C section-ISA~~ 320<sup>25</sup> and ~~AU-C section-ISA~~ 450,<sup>26</sup> when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, for those components on which the group auditor or component auditor will perform audit procedures, the group auditor ~~shall~~should determine:
- Component performance materiality. To address aggregation risk, such amount ~~shall~~should be lower than group performance materiality. (Ref: Para. A114–A118)
  - The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor. Such threshold ~~shall~~should not exceed the amount regarded as clearly trivial to the group financial statements. (Ref: Para. A119)

### Considerations When Component Auditors Are Involved

36. The group auditor ~~shall~~should communicate to the component auditor the amounts determined in accordance with paragraph 35. (Ref: Para: A120–A121)

### Responding to the Assessed Risks of Material Misstatement

37. In applying ~~AU-C section-ISA~~ 330,<sup>27</sup> the group auditor ~~shall~~should take responsibility for the nature, timing, and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing, and extent of the work to be performed at those components. (Ref: Para. A122–A137)

### Consolidation Process

38. The group auditor ~~shall~~should take responsibility for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This ~~shall~~should include: (Ref: Para. A138)
- Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub-consolidations;
  - Evaluating the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications; (Ref: Para. A139)
  - Evaluating whether management's judgments made in the consolidation process give rise to indicators of possible management bias; and
  - Responding to assessed risks of material misstatement due to fraud arising from the consolidation process.
39. If the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group auditor ~~shall~~should

<sup>25</sup> ~~Paragraph 11 of AU-C section-ISA 320, paragraph 11~~

<sup>26</sup> ~~Paragraph 5 of AU-C section-ISA 450, Evaluation of Misstatements Identified During the Audit, paragraph 5~~

<sup>27</sup> ~~Paragraphs 6-7 of AU-C section-ISA 330, paragraphs 6–7~~

evaluate whether the financial information has been appropriately adjusted for purposes of ~~preparing the preparation and fair presentation~~ing of the group financial statements ~~in accordance with the applicable financial reporting framework~~.

40. If the group financial statements include the financial information of an entity or business unit with a financial reporting period-end that differs from that of the group, the group auditor ~~shall~~should take responsibility for evaluating whether appropriate adjustments have been made to that financial information in accordance with the applicable financial reporting framework.

#### *Considerations When Component Auditors Are Involved*

41. When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor ~~shall~~should communicate with the component auditor about matters that the group auditor or component auditor determine to be relevant to the design of responses to the assessed risks of material misstatement of the group financial statements.
42. For areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with ~~AU-C section 315~~SA 315 (Revised 2019), on which a component auditor is determining the further audit procedures to be performed, the group auditor ~~shall~~should evaluate the appropriateness of the design and performance of those further audit procedures. (Ref: Para. A140)
43. When component auditors perform further audit procedures on the consolidation process, including on sub-consolidations, the group auditor ~~shall~~should determine the nature and extent of direction and supervision of component auditors and the review of their work. (Ref: Para. A141)
44. The group auditor ~~shall~~should determine whether the financial information identified in the component auditor's communication (see paragraph 45(a)) is the financial information that is incorporated in the group financial statements.

#### **Evaluating the Component Auditor's Communications and the Adequacy of Their Work**

45. The group auditor ~~should~~shall request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication ~~shall~~should include: (Ref: Para. A142)
- (a) Identification of the financial information on which the component auditor has been requested to perform audit procedures;
  - (b) Whether the component auditor has performed the work requested by the group auditor;
  - (c) Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement;
  - (d) Information about instances of non-compliance with laws or regulations;
  - (e) Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph 36; (Ref: Para. A143)
  - (f) Indicators of possible management bias;
  - (g) Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed;
  - (h) Fraud or suspected fraud involving component management, employees at entities or business

units who have significant roles in the group's system of internal control at the component or others at entities or business units where the fraud resulted in a material misstatement of the component financial information;

- (i) Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component;
  - (j) Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in the written representations that the component auditor requested from component management; and
  - (k) The component auditor's overall findings or conclusions. (Ref: Para. A144)
46. The group auditor ~~shall~~should:
- (a) Discuss significant ~~matters~~findings and issues arising from communications with the component auditor, including those in accordance with paragraph 45, with the component auditor, component management or group management, as appropriate; and
  - (b) Evaluate whether communications with the component auditor are adequate for the group auditor's purposes. If such communications are not adequate for the group auditor's purposes, the group auditor shall consider the implications for the group audit. (Ref: Para. A144A)
47. The group auditor ~~shall~~should determine whether, and the extent to which, it is necessary to review additional component auditor audit documentation. In making this determination, the group auditor ~~shall~~should consider: (Ref: Para. A145–A146)
- (a) The nature, timing and extent of the work performed by the component auditor;
  - (b) The competence and capabilities of the component auditor as determined in accordance with paragraph 26(a); and
  - (c) The direction and supervision of the component auditor and review of their work.
48. If the group auditor concludes that the work of the component auditor is not adequate for the group auditor's purposes, the group auditor ~~shall~~should determine what additional audit procedures are to be performed, and whether they are to be performed by a component auditor or by the group auditor.

### **Subsequent Events**

49. In applying ~~AU-C section~~ISA 560,<sup>28</sup> the group auditor ~~shall~~should take responsibility for performing procedures, including, as appropriate, requesting component auditors to perform procedures, designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: Para. A147)

### *Considerations When Component Auditors Are Involved*

50. The group auditor ~~shall~~should request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements. (Ref: Para. A147)

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<sup>28</sup> ~~Paragraphs 9-10 of AU-C section~~ ISA 560, *Subsequent Events*, ~~paragraphs 6–7~~

## Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements

### Understanding the Referred-To Auditor

#### Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors

50.1 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for: (Ref: Para. A56–A57, A84, A147.2)

- (a) Referred-to auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and
- (b) Confirming whether the referred-to auditors understand and will comply with the ethical requirements that are relevant to the group audit engagement, including those related to independence.

#### Competence and Capabilities of Referred-To Auditors

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
- (b) If information about the results of the monitoring and remediation process or external inspections related to the referred-to auditor has been provided by the group auditor's firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor's determination in paragraph 50.2(a). (Ref: Para. A147.3-A147.3.2)

50.3. The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements if: (Ref: Para. A67–A68)

- (a) The referred-to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.
- (b) The group engagement partner has serious concerns about the matters in paragraphs 50.1-50.2.

### The Consolidation Process

50.3.1 The group auditor should obtain an understanding of whether the group auditor will be able to obtain information affecting the consolidation process from group management or a referred-to auditor.

#### Determining Whether to Make Reference (Ref: Para. A147.4-A147.9.)

50.4. Having obtained an understanding of the referred-to auditor, the group engagement partner should determine whether to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

50.5 Reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless:

- (a) the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of

GAAS (Ref: Para. .A147.5), and

(b) the referred-to auditor has issued an auditor's report that is not restricted as to use.

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

(a) the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group, and

(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 be involved in, the work of the auditor. (Ref: Para. A147.5-A147.9)

50.5.2 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the group engagement team should obtain sufficient appropriate audit evidence with regard to such components by performing the following procedures:

a. The procedures required by this proposed SAS related to making reference to the audit of a referred-to auditor.

b. Reading the component's financial statements and the referred-to auditor's report thereon to identify significant findings and issues.

Making Reference (Ref: Para. A147.10-A147.12)

50.6 When the group engagement partner determines to make reference, the report on the group financial statements should clearly indicate

(a) that the component was not audited by the group auditor but was audited by the referred-to auditor.

(b) the magnitude of the portion of the financial statements audited by the referred-to auditor.

(c) when the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements

(i) the financial reporting framework used by the component and

(ii) that the group auditor is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group in accordance with paragraph 39. (Ref: Para. A147.6)

(d) when

(i) the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and

(ii) the group engagement partner has determined that the referred-to auditor performed additional audit procedures in order to meet the relevant requirements of GAAS

- (a) the set of auditing standards used by the referred-to auditor and
- (b) that additional audit procedures were performed by the referred-to auditor to meet the relevant requirements of GAAS.

50.7 If the group engagement partner determines to name a referred-to auditor in the auditor's report on the group financial statements:

- (a) the referred-to auditor's express permission should be obtained.
- (b) the referred-to auditor's report should be presented together with that of the auditor's report on the group financial statements.

50.8 If the opinion of a referred-to auditor is modified or that audit report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section, the group auditor should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the group auditor should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph, ~~or~~ an other-matter paragraph, or a going concern section in the auditor's report on the group financial statements. (Ref. Para. AA147.13)

*Communications With the Referred-To Auditor*

50.9 The group auditor should communicate to a referred-to auditor on a timely basis:

- a. In accordance with paragraph 50.1, the ethical requirements that are relevant to the group audit engagement, including those related to independence.
- b. In applying AU-C section 550,<sup>29</sup> related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the referred-to auditor.
- c. Identified significant risks of material misstatement of the group financial statements, whether due to fraud or error, that are relevant to the work of the referred-to auditor.
- d. A request that the referred-to auditor communicate on a timely basis:
  - i. Confirmation that the referred-to auditor will cooperate with the group auditor.
  - ii. Related party relationships not previously identified by group management or the group auditor. Additionally, the group engagement team should identify such additional related parties to other component auditors and referred-to auditors, as applicable;
  - iii. If the group engagement partner decides to name a component.;
  - iv. express permission for the group engagement partner to name a referred-to auditor in the auditor's report on the group financial statements in accordance with paragraph 50.7(a).

50.10 The group auditor should request a referred-to auditor to communicate matters relevant to the group auditor's conclusion, with regard to the group audit. Such communication should include the following:

- a. Whether the referred-to auditor has complied with ethical requirements that are relevant to the group audit engagement, including independence

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<sup>29</sup> Paragraph 19 of AU-C section 550, *Related Parties*

b. Identification of the financial information of the component on which the referred-to auditor is reporting

c. The referred-to auditor's audit report and opinion.

#### Evaluating a Referred-To Auditor's Communication

50.11 The group auditor should evaluate a referred-to auditor's communication (see paragraph 50.9(d) and 50.10). The group auditor should discuss significant findings and issues arising from that evaluation with the referred-to auditor, component management, or group management, as appropriate.

50.12 The group auditor should determine whether the financial information identified in the referred-to auditor's communications (see paragraph 50.10(b)) is the financial information that is incorporated in the group financial statements.

#### Subsequent Events

50.13 The group auditor should take responsibility for requesting referred-to auditors, as appropriate, to perform procedures designed to identify events that may require adjustment of, or disclosure in, the group financial statements.

#### **Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

51. In applying AU-C section ISA 330,<sup>30</sup> the group auditor ~~shall~~should evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including from the work performed by component auditors or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements (paragraph 58.11-58.13), on which to base the group audit opinion. (Ref: Para. A148–A152)

52. The group engagement partner ~~shall~~should evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) and any instances when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: Para. A153)

#### **Auditor's Report**

~~53. The auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor's report shall indicate that the reference does not diminish the group engagement partner's or the group engagement partner's firm's responsibility for the group audit opinion. (Ref: Para. A154–A155)~~

#### **Communication with Group Management and Those Charged with Governance of the Group**

##### *Communication with Group Management*

54. The group auditor ~~shall~~should communicate with group management an overview of the planned scope and timing of the audit, including an overview of the work to be performed at components of the group. (Ref: Para. A156)

55. If fraud has been identified by the group auditor or brought to its attention by a component auditor (see paragraph 45(h)), or information indicates that a fraud may exist, the group auditor ~~shall~~should communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their

<sup>30</sup> ~~Paragraph 28 of AU-C section ISA 330, paragraph 26~~

responsibilities. (Ref: Para. A157)

56. ~~When a~~ component auditor ~~has been engaged may be required by statute, regulation, or other reasons~~ to express an audit opinion on the financial statements of an entity or business unit that forms part of the group. ~~In that case,~~ the group auditor ~~shall should~~ request group management to inform management of the entity or business unit of any matter of which the group auditor becomes aware that may be significant to the financial statements of the entity or business unit, but of which management of the entity or business unit may be unaware. If group management refuses to communicate the matter to management of the entity or business unit, the group auditor ~~shall should~~ discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group auditor, subject to legal and professional confidentiality considerations, ~~shall should~~ consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the entity or business unit until the matter is resolved ~~and whether to withdraw from the engagement~~. (Ref: Para. A158–A159)

*Communication with Those Charged with Governance of the Group*

57. The group auditor ~~shall should~~ communicate the following matters with those charged with governance of the group, in addition to those required by ~~AU-C section ISA 260, *Communication with Those Charged with Governance (Revised)*~~<sup>31</sup> and other ~~AU-C sections ISAs~~: (Ref: Para. A160)
- (a) An overview of the work to be performed at the components of the group, ~~including the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements,~~ and the nature of the group auditor's planned involvement in the work to be performed by component auditors. (Ref: Para. A161)
  - (b) Instances when the group auditor's review of the work of a component auditor gave rise to a concern about the quality of that component auditor's work, and how the group auditor addressed the concern.
  - (c) Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information.
  - (d) Fraud or suspected fraud involving group management, component management, employees ~~at entities or business units~~ who have significant roles in the group's system of internal control or others ~~at entities or business units in which when the fraud resulted in~~ a material misstatement of the group financial statements ~~has or may have resulted from fraud~~.

*Communication of Identified Deficiencies in Internal Control*

58. In applying ~~AU-C section ISA 265, *Communicating Internal Control Related Matters Identified in an Audit*~~<sup>32</sup> the group auditor ~~shall should~~ determine whether any identified deficiencies in the group's system of internal control are required to be communicated to those charged with governance of the group or group management. In making this determination, the group auditor ~~shall should~~ consider deficiencies in internal control that have been identified by component auditors and communicated to the group auditor in accordance with paragraph 45(g). (Ref: Para. A162)

<sup>31</sup> ~~AU-C section ISA 260 (Revised), *Communication with Those Charged with Governance*~~

<sup>32</sup> ~~AU-C section ISA 265, *Communicating Deficiencies in Internal Control Related Matters Identified in an Audit to Those Charged with Governance and Management*~~

**Documentation**

59. In accordance with ~~AU-C section-ISA~~ 230,<sup>33</sup> the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying ~~AU-C section-ISA~~ 230,<sup>34</sup> the group auditor ~~shall-should~~ include in the audit documentation the following: (Ref: Para. A163–A166, A176–A179)

- (a) Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed.
- (b) The basis for the group auditor’s determination of components for purposes of planning and performing the group audit. (Ref: Para. A167)
- (c) The basis for the determination of component performance materiality and the threshold for communicating misstatements in the component financial information to the group auditor.
- (d) The basis for the group auditor’s determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components. (Ref: Para. A168)
- (e) Key elements of the understanding of the group’s system of internal control in accordance with paragraph 30(c);
- (f) The nature, timing and extent of the group auditor’s direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor’s review of additional component auditor audit documentation in accordance with paragraph 47. (Ref: Para. A169–A175)
- (g) Matters related to communications with component auditors, including:
  - (i) Matters, if any, related to fraud, related parties, or going concern communicated in accordance with paragraph 32.
  - (ii) Matters relevant to the group auditor’s conclusion with regard to the group audit, in accordance with paragraph 45, including how the group auditor has addressed significant matters discussed with component auditors, component management or group management.

~~(g.1)~~(e) Those components for which reference to the audit of referred-to auditors is made in the auditor’s report on the group financial statements.

~~(g.2)~~For those components for which reference to the audit of referred-to auditors is made in the auditor’s report on the group financial statements

i. the financial statements of the component and the report of the referred-to auditor thereon

ii. when the referred-to auditor’s report on the component’s financial statements does not state that the audit of the component’s financial statements was performed in

<sup>33</sup> ~~Paragraph 8 of AU-C section-ISA~~ 230, ~~paragraph 8~~

<sup>34</sup> ~~Paragraphs 1-3, 9-12, A8-A9, and the Exhibit in AU-C section~~ ISA 230, ~~paragraphs 1–3, 9–11, A6–A7 and Appendix~~

accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the referred-to auditor met the relevant requirements of GAAS

iii. The basis for the group auditor's determination that referred-to auditors have the appropriate competence and capabilities

iv. Matters related to communications with referred-to auditors communicated in accordance with paragraphs 50.9(d) and 50.10, including how the group auditor has addressed significant matters discussed with referred-to auditors, component management or group management.

(h) The group auditor's evaluation of, and response to, findings or conclusions of the component auditors or referred-to auditors about matters that could have a material effect on the group financial statements.

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## Application and Other Explanatory Material

**Scope of this ~~Proposed SAS~~ISA** (Ref: Para. 1–2)

- A1. This ~~proposed SAS~~ISA also ~~addresses deals with~~ the special considerations for the group engagement partner or group auditor, as applicable, in applying the requirements and guidance in ~~proposed QM SAS-ISA 220 (Revised)~~, including for the direction and supervision of component auditors and the review of their work.
- A2. ~~Proposed Statement on Quality Management Standards (SQMS) 1, A Firm's System of Quality Management-ISQM-1,~~<sup>35</sup> addresses the engagements for which an engagement quality review is required to be performed. ~~Proposed ISQMS 2, Engagement Quality Reviews,~~<sup>36</sup> ~~addresses deals with~~ the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review, including for a group audit.
- A3. An entity or business unit of a group may also prepare its own group financial statements that incorporate the financial information of those entities or business units it encompasses (that is, a sub-group). This ~~proposed SAS~~ISA applies to an audit of the group financial statements of such sub-groups performed for ~~statutory/legal~~, regulatory, or other reasons.
- A4. A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a bank with multiple branches. When those business units have characteristics such as separate locations, separate management, or separate information systems (including a separate general ledger) and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.
- A5. In some cases, a single legal entity may configure its information system to capture financial

<sup>35</sup> ~~Proposed Statement International Standard on Quality Management Standards (ISQMS) 1, A Firm's System of Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements~~

<sup>36</sup> ~~Proposed ISQMS 2, Engagement Quality Reviews~~

information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this [proposed SAS](#).

*Groups and Components* (Ref: Para. 4–5)

- A6. The group's information system, including its financial reporting process, may or may not be aligned with the group's organizational structure. For example, a group may be organized according to its legal structure, but its information system may be organized by function, process, product, or service (or by groups of products or services), or geographic locations for management or reporting purposes.
- A7. Based on the understanding of the group's organizational structure and information system, the group auditor may determine that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the group auditor may decide to treat these three legal entities as one component.
- A8. A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example through the use of a shared service center. When such centralized activities are relevant to the group's financial reporting process, the group auditor may determine that the shared service center is a component.
- A9. Another consideration that may be relevant to the group auditor's determination of components is how management has determined operating segments in accordance with the disclosure requirements of the applicable financial reporting framework.<sup>37</sup>

*Involvement of Component Auditors* (Ref: Para. 6–8)

- A10. Component auditors may perform an audit of the financial statements of a component, whether for [statutory/legal](#), regulatory, or other reasons, particularly when a component is a legal entity. When a component auditor is also performing or has completed an audit of the component financial statements, the group auditor may be able to use audit work performed on the component financial statements, provided the group auditor is satisfied that such work is appropriate for purposes of the group audit. In addition, component auditors may adapt the work performed on the audit of the component financial statements to also meet the needs of the group auditor. 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.
- A10A. In accordance with ISA 220 (Revised),<sup>38</sup> the engagement partner is required to determine that the approach to direction, supervision and review is responsive to the nature and circumstances of the audit engagement. Paragraph A73 provides examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work, and may be helpful in circumstances when the group auditor plans to use the

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<sup>37</sup> See, for example, [FASB Accounting Standards Codification Manual \(ASC\) 280, Operating Segment Reporting](#)

<sup>38</sup> [ISA 220 \(Revised\), paragraph 30\(b\)](#)

audit work from an audit of component financial statements that has already been completed.

- A11. As explained in [AU-C section ISA 200](#),<sup>39</sup> detection risk relates to the nature, timing and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. Detection risk is a function not only of the effectiveness of an audit procedure but also the application of that procedure by the auditor. Therefore, detection risk is influenced by matters such as adequate planning, the assignment of appropriate resources to the engagement, the exercise of professional skepticism, and the supervision and review of the audit work performed.
- A12. Detection risk is a broader concept than aggregation risk as described in paragraphs 14(a) and A18. In a group audit, there may be a higher probability that the aggregate of uncorrected and undetected misstatements may exceed materiality for the group financial statements as a whole because audit procedures may be performed separately on the financial information of components across the group. Accordingly, component performance materiality is set by the group auditor to reduce aggregation risk to an appropriately low level.

*[Making Reference to the Audit of a Referred-To Auditor](#)*

[A12.1 When component auditors are involved in the audit of the group financial statements, no reference is made to the component auditor in the report on the group audit because to do so may cause a reader to misinterpret the degree of responsibility of the group auditor.](#)

*Professional Skepticism (Ref: Para. 9)*

- A13. [Proposed QM SAS-ISA 220 \(Revised\)](#)<sup>40</sup> provides examples of the impediments to the exercise of professional skepticism at the engagement level, including unconscious auditor biases that may impede the exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. [Proposed QM SAS-ISA 220 \(Revised\)](#) also provides possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level.
- A14. Requirements and relevant application material in [AU-C section 315](#)~~ISA 315 (Revised 2019)~~,<sup>41</sup> [AU-C section ISA 540 \(Revised\)](#)<sup>42</sup> and other [AU-C sections](#)~~ISAs~~ address the exercise of professional skepticism, and include examples of how documentation may help provide evidence of the auditor's exercise of professional skepticism.
- A15. All members of the engagement team are required to exercise professional skepticism throughout the group audit. The group auditor's direction and supervision of engagement team members, including component auditors, and the review of their work, may inform the group auditor about whether the engagement team has appropriately exercised professional skepticism.
- A16. The exercise of professional skepticism in a group audit may be affected by matters such as the following:
- Component auditors in different locations may be subject to varying cultural influences, which may affect the nature of the biases to which they are subject.
  - The complex structure of some groups may introduce factors that give rise to increased

<sup>39</sup> [Paragraph A49 of AU-C section ISA 200](#), ~~paragraph A45~~

<sup>40</sup> [Paragraphs A34-A36 of proposed QM SAS ISA 220 \(Revised\)](#), ~~paragraphs A34–A36~~

<sup>41</sup> [Paragraph A268 of AU-C section 315](#)~~ISA 315 (Revised 2019)~~, ~~paragraph A238~~

<sup>42</sup> [Paragraph A11 of SAS No. ISA-540 \(Revised\)](#), *Auditing Accounting Estimates and Related Disclosures*, ~~paragraph A14~~

susceptibility to risks of material misstatement. In addition, an overly complex organizational structure may be a fraud risk factor in accordance with [AU-C section ISA 240](#)<sup>43</sup> and therefore may require additional time or expertise to understand the business purpose and activities of certain entities or business units.

- The nature and extent of intra-group transactions (e.g., transactions that involve multiple entities and business units within the group or multiple related parties), cash flows or transfer pricing agreements may give rise to additional complexities. In some cases, such matters may also give rise to fraud risk factors.
- When the group audit is subject to tight reporting deadlines ~~imposed by group management~~, this may put pressure on engagement team members when completing the work assigned. In these circumstances, the engagement team may need to take additional time to appropriately question management’s assertions, make appropriate judgments, or appropriately review the audit work performed.

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- A17. The exercise of professional skepticism by the group auditor includes remaining alert for inconsistent information from component auditors, component management and group management about matters that may be significant to the group financial statements.

*[Responsibilities of the Group Engagement Partner and Group Auditor \(Ref: Para. 11\)](#)*

[A17.1. Component auditors or referred-to auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings or conclusions. However, regardless of whether reference is made in the auditor’s report on the group financial statements to the report of a referred-to auditor, the group engagement partner or the group engagement partner’s firm is responsible for the group audit opinion.](#)

[A17.2. When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Qualified Opinion or Basis for Disclaimer of Opinion section in the auditor’s report on the group financial statements describes the reasons for that inability.<sup>44</sup> In some circumstances, a reference to a component auditor or referred-to auditor may be necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.](#)

[A17.3. When the group auditor is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements, the auditor’s reporting responsibilities with respect to the separate financial statements are the same as the auditor’s responsibilities with respect to the group financial statements.](#)

**Definitions**

*Aggregation Risk (Ref: Para. 14(a))*

A18. Aggregation risk exists in all audits of financial statements, but is particularly important to understand

<sup>43</sup> [Appendix A of AU-C section ISA 240, Consideration of The Auditor’s Responsibilities Relating to Fraud in an Financial Statement Audit of Financial Statements, Appendix 1](#)

<sup>44</sup> [Paragraphs 21 and 25 of AU-C section 705](#)

and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances or disclosures that are disaggregated across components. Generally, aggregation risk increases as the number of components increases at which audit procedures are performed separately, whether by component auditors or other members of the engagement team, or by referred-to auditors.

*Component* (Ref: Para. 14(b))

A19. The group auditor uses professional judgment in determining components at which audit work will be performed. Paragraph A7 explains that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. However, the group auditor's responsibility for the identification and assessment of the risks of material misstatement of the group financial statements encompasses all of the entities and business units whose financial information is included in the group financial statements.

*Considerations Specific to Governmental Entities* (Ref: Para. 14(b))

A19.1. In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

*Component Auditor* (Ref: Para. 14(c))

A20. References in this proposed SAS to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).

A20.1 An auditor who performs work on a component when the group auditor will not use that work to provide audit evidence for the group audit is not considered a component auditor.

A21. In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

A21A. Paragraph 24 requires the group auditor to request the component auditor to confirm that the component auditor will cooperate with the group auditor and perform the work requested by the group auditor. Paragraph A55 provides guidance for circumstances in which the component auditor is unable to provide such a confirmation.

*Component Management* (Ref: Para. 14(d))

A22. Component management refers to management responsible for the financial information or other activity (e.g., processing of transactions at a shared service center) at an entity or business unit that is part of the group. When the group auditor considers the financial information of certain entities or business units together as a component or determines that a shared service center is a component (see paragraphs A7–A8), component management refers to the management that is responsible for the financial information or transaction processing that is subject to the audit procedures being performed in relation to that component. In some circumstances, there may not be separate component management and group management may be directly responsible for the financial information or other activities of the component.

*Group Engagement Partner* (Ref: Para. 14(j))

A23. When joint auditors conduct a group audit, the joint engagement partners and their engagement teams collectively constitute the "group engagement partner" and "engagement team" for the purposes of GAAS~~the ISAs~~. This proposed SAS does not, however, deal with the relationship

between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor for purposes of the group audit.

*Group Financial Statements* (Ref: Para. 2, 14(k))

- A24. The requirements for the preparation and presentation of the group financial statements may be specified in the applicable financial reporting framework, which may therefore affect the determination of the financial information of entities or business units to be included in the group financial statements. For example, some frameworks require the preparation of consolidated financial statements when an entity (a parent entity) controls one or more other entities (e.g., subsidiaries) through majority ownership interest or other means. In some cases, the applicable financial reporting framework includes separate requirements for, or may otherwise permit, the presentation of combined financial statements. Examples of circumstances in which the presentation of combined financial statements may be permitted include entities that ~~have no parent but~~ are under common control or entities under common management.
- A25. The term “consolidation process” as used in this ~~proposed SAS~~~~ISA~~ is not intended to have the same meaning as “consolidation” or “consolidated financial statements” as defined or described in financial reporting frameworks. Rather, the term “consolidation process” refers more broadly to the process used to prepare group financial statements.
- A26. The detailed aspects of the consolidation process vary from one group to another, depending on the group’s structure and information system, including the financial reporting process. However, a consolidation process involves considerations such as the elimination of intra-group transactions and balances and, when applicable, implications of different reporting periods for entities or business units included in the group financial statements.

*Referred-To Auditor* (Ref: Para. 14(m.1))

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.

*Considerations Specific to Governmental Entities* (Ref: Para. 1, 15)

A26.2 In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

**Leadership Responsibilities for Managing and Achieving Quality on a Group Audit** (Ref: Para. 11, 16)

- A27. It may not be possible or practical for the group engagement partner to solely deal with all requirements in ~~proposed QM SAS-ISA 220 (Revised)~~, particularly when the engagement team includes a large number of component auditors located in multiple locations. In managing quality at the engagement level, ~~proposed QM SAS-ISA 220 (Revised)~~<sup>45</sup> permits the engagement partner to assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the engagement partner. Accordingly, the group engagement partner may assign procedures, tasks or actions to other members of the engagement team and these members may assign procedures, tasks, or actions further. In such circumstances, ~~proposed QM SAS ISA 220 (Revised)~~ requires that the engagement partner ~~shall~~~~should~~ continue to take overall

<sup>45</sup> Paragraph 15 of proposed QM SAS ISA 220 (Revised), paragraph 15

responsibility for managing and achieving quality on the audit engagement.

A28. Policies or procedures established by the firm, or that are common network requirements or network services,<sup>46</sup> may support the group engagement partner by facilitating communication between the group auditor and component auditors and supporting the group auditor's direction and supervision of those component auditors and the review of their work.

A29. ~~Proposed QM SAS ISA-220 (Revised)~~<sup>47</sup> explains that a culture that demonstrates a commitment to quality is shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. In addressing the requirement in paragraph 16(a), the group engagement partner may communicate directly to other members of the engagement team (including component auditors) and reinforce this communication through personal conduct and actions (e.g., leading by example).

### Acceptance and Continuance

*Determining Whether Sufficient and Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained* (Ref: Para. 17–18)

A30. In determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, the group engagement partner may obtain an understanding of matters such as:

- The group structure, including both the legal and organizational structure.
- Activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place.
- The use of service organizations.
- The use of shared service centers.
- The consolidation process.
- Whether the group auditor:
  - Will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management and component information, including of those components that are accounted for by the equity method; and
  - Will be able to perform necessary work on the financial information of the components when applicable.
- Whether sufficient and appropriate resources are assigned or will be made available.

A31. In the case of an initial group audit engagement, the group auditor's understanding of the matters in paragraph A30 may be obtained from:

- Information provided by group management;
- Communication with group management;

<sup>46</sup> ~~Paragraphs 49-53 of proposed ISQMS 1, paragraphs 48–52~~

<sup>47</sup> ~~Paragraph A28 of proposed QM SAS ISA-220 (Revised), paragraph A28~~

- Communication with those charged with governance of the group; and
  - When applicable, communication with component management or the predecessor auditor.
- A32. For a recurring engagement, the ability to obtain sufficient appropriate audit evidence may be affected by significant changes, for example, changes in:
- The group structure (e.g., acquisitions, disposals, joint ventures, reorganizations, or changes in how the group financial reporting system is organized).
  - Components' activities that are significant to the group.
  - The composition of those charged with governance of the group, group management, or key management of components for which audit procedures are expected to be performed.
  - The group auditor's understanding of the integrity and competence of group or component management.
  - Changes in the applicable financial reporting framework.
- A33. There may be additional complexities with obtaining sufficient appropriate audit evidence in a group audit when components are located in jurisdictions other than the group auditor's jurisdiction because of cultural and language differences, and different laws or regulations. For example, Law or regulation may restrict the component auditor from providing documentation outside of its jurisdiction, or war, civil unrest or outbreaks of disease may restrict the group auditor's access to relevant component auditor audit documentation. Paragraph A177 includes possible ways to address these situations.
- A33.1. In addition to the work performed by the group auditor, the group engagement partner may obtain sufficient appropriate audit evidence regarding the financial information of one or more components through using the work of a component auditor or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.
- A33.2 There may be more complexities in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit where the audit report of a referred-to auditor is made reference to. The group engagement partner may consider the nature and extent of work performed by referred-to auditors, including matters such as:
- The financial significance of the components that are audited by referred-to auditors and for which the group auditor plans to make reference to in the auditor's report on the group financial statements.
  - The risks of material misstatement associated with the portion of the company's financial statements for which the group auditor or component auditor performs audit procedures, in comparison with the portion audited by referred-to auditors.
- A34. Restrictions may be imposed after the group engagement partner's acceptance of the group audit engagement that may affect the engagement team's ability to obtain sufficient appropriate audit evidence. Such restrictions may include those affecting:
- The group auditor's access to component information, management or those charged with governance of components, or the component auditors (including relevant audit documentation sought by the group auditor) (see paragraphs 20 and 21); or
  - The work to be performed on the financial information of components.

Paragraphs A42–A43 explain the possible effect of such restrictions on the auditor’s report on the group financial statements.

*Agreeing the Terms of Audit Engagements* (Ref: Para. 19)

A35. ~~AU-C section ISA~~ 210<sup>48</sup> requires the auditor to agree the terms of the audit engagement with management or those charged with governance, as appropriate. The terms of engagement identify the applicable financial reporting framework. Additional matters that may be included in the terms of a group audit engagement include ~~whether reference will be made in the audit of a referred-to auditor in the auditor’s report on the group financial statements, when relevant, or arrangements to facilitate the following:~~

- ~~Unrestricted C~~ommunications between the group auditor and component auditors, ~~should be unrestricted~~ to the extent ~~possible underpermitted by~~ laws or regulations;
- ~~Important c~~ommunications ~~to the group auditor of important communications~~ between
  - component auditors and those charged with governance of the component or component management, including communications on significant deficiencies and material weaknesses in internal control
  - regulatory authorities and entities or business units related to financial reporting matters that may be relevant to the group audit ~~should be communicated to the group auditor; and~~
- ~~Permission for T~~he group auditor ~~should be permitted~~ to perform work, or request a component auditor to perform work, at the component.

*Restrictions on Access to Information or People* (Ref: Para. 20–21)

A36. Restrictions on access to information or people do not eliminate the requirement for the group auditor to obtain sufficient appropriate audit evidence.

A37. Access to information or people can be restricted for many reasons, such as restrictions imposed by component management, laws or regulations or other conditions, for example, war, civil unrest, or outbreaks of disease. Paragraph A177 describes how the group auditor may be able to overcome restrictions on access to component auditor audit documentation.

A38. In some circumstances, the group auditor may be able to overcome restrictions on access to information or people, for example:

- If access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the group.
- If the group has a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may determine whether provisions exist (e.g., in the terms of joint venture agreements, or the terms of other investment agreements) regarding access by the group to the financial information of the entity and request group management to exercise such rights.
- If the group has a non-controlling interest in an entity that is accounted for by the equity method

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<sup>48</sup> ~~Paragraphs 9 and 10 ( e) of AU-C section ISA 210, paragraph 9 and 10(d)~~

and the group has representatives who are on the executive board or are members of those charged with governance of the non-controlled entity, the group auditor may inquire whether they can provide financial and other information available to them in these roles.

A39. If the group has a non-controlling interest in an entity that is accounted for by the equity method and the group auditor's access to information or people at the entity is restricted, the group auditor may be able to obtain information to be used as audit evidence regarding the entity's financial information, for example:

- Financial information that is available from group management, as group management also needs to obtain the non-controlled entity's financial information in order to prepare the group financial statements.
- Publicly available information, such as audited financial statements, public disclosure documents, or quoted prices of equity instruments in the non-controlled entity.
- Financial statements audited by a referred-to auditor when the group auditor makes reference to the audit of a referred-to auditor in the group audit report.

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can obtain sufficient appropriate audit evidence.<sup>49</sup>

A39A. If the group has a non-controlling interest in an entity that is accounted for by the equity method and access to information or people at the entity is restricted, the group auditor may consider whether such restrictions are inconsistent with group management's assertions regarding the appropriateness of the use of the equity method of accounting.

A40. When the group auditor is unable to obtain sufficient appropriate audit evidence due to cannot overcome restrictions on access to information or people, the group auditor may:

- Communicateing the restrictions to the group auditor's firm can to assist the group auditor in determining an appropriate course of action. For example, the group auditor's firm may communicate with group management about the restrictions and encourage group management to communicate with regulators. This may be useful when restrictions affect multiple audits in the jurisdiction or by the same firm, for example, because of war, civil unrest, or outbreaks of disease in a major economy.
- ~~For a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may discuss with group management whether restrictions on group management's ability to provide access to information or people indicate that the equity method of accounting may not be appropriate in accordance with the applicable financial reporting framework.~~
- ~~The group auditor may be~~ required by law or regulation to communicate with regulators, listing authorities, or others, about the restrictions.

<sup>49</sup> Paragraph 7(b) of AU-C section ISA 330, paragraph 7(b)

A41. Restrictions on access may have other implications for the group audit. For example, if restrictions are imposed by group management, the group auditor may need to reconsider the reliability of group management's responses to the group auditor's inquiries and whether the restrictions call into question group management's integrity.

*Effect of Restrictions on Access to Information or People on the Auditor's Report on Group Financial Statements*

A42. AU-C section ISA 705 (Revised)<sup>50</sup> contains requirements and guidance about how to address situations when the group auditor is unable to obtain sufficient appropriate audit evidence. Appendix 1 contains an example of an auditor's report containing a qualified group audit opinion based on the group auditor's inability to obtain sufficient appropriate audit evidence in relation to a component that is accounted for by the equity method.

*Law or Regulation Prohibit the Group Engagement Partner from Declining or Withdrawing from an Engagement*

A43. ~~Law or regulation may prohibit the group engagement partner from declining or withdrawing from an engagement. For example, in some jurisdictions the auditor is appointed for a specified period of time and is prohibited from withdrawing before the end of that period. Also, in the public sector, the option of declining or withdrawing from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, the requirements in this proposed SAS ISA still apply. AU-C Section 210 addresses circumstances when an entity is required by law or regulation to have an audit. In these circumstances, this proposed SAS still applies to the group audit, and the effect of the group auditor's inability to obtain sufficient appropriate audit evidence is addressed in AU-C section ISA 705 (Revised).~~

**Overall Group Audit Strategy and Group Audit Plan**

*The Continual and Iterative Nature of Planning and Performing a Group Audit (Ref: Para. 22)*

A44. As explained in AU-C section ISA 300,<sup>51</sup> planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. For example, due to unexpected events, changes in conditions, or audit evidence obtained from risk assessment or further audit procedures, the group auditor may need to modify the overall group audit strategy and group audit plan, and the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The group auditor may also modify the determination of the components at which to perform audit work as well as the nature, timing, and extent of the component auditors' involvement. AU-C section ISA 300<sup>52</sup> requires the auditor to update and change the overall audit strategy and audit plan as necessary during the course of the audit.

A44.1 The form of the group audit strategy and group audit plan may vary based on the nature and circumstances of each group audit engagement, including the extent to which engagement management is integrated into the audit tools used for the group audit. An electronic audit tool may be used to develop and update the group audit strategy and audit plan, and facilitate the group engagement partner's review of the group audit plan and group audit strategy.

<sup>50</sup> AU-C section ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*

<sup>51</sup> Paragraph A2 of AU-C section ISA 300, ~~paragraph A2~~

<sup>52</sup> Paragraph 10 of AU-C section ISA 300, ~~paragraph 10~~

*Establishing the Overall Group Audit Strategy and Group Audit Plan* (Ref: Para. 22)

- A45. In an initial group audit engagement, the group auditor may have a preliminary understanding of the group and its environment, the applicable financial reporting framework and the entity's system of internal control based on information obtained from group management, those charged with governance of the group and, when applicable, communication with component management or the predecessor auditor. In a recurring group audit engagement, the group auditor's preliminary understanding may be obtained through prior period audits. This preliminary understanding may assist the group auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant.
- A46. The group auditor may also use information obtained during the engagement acceptance and continuance process in establishing the overall group audit strategy and group audit plan, for example, in relation to the resources needed to perform the group audit.
- A47. The process of establishing the overall group audit strategy and group audit plan and initial expectations about the classes of transactions, account balances and disclosures that may be significant at the group financial statement level may assist the group auditor in developing a preliminary determination of matters such as:
- Whether to perform audit work centrally, at components or a combination thereof; and
  - The nature, timing, and extent of audit work to be performed with respect to the financial information of components (e.g., design and perform risk assessment procedures, further audit procedures, or a combination thereof).
  - The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor.

*Components at Which to Perform Audit Work* (Ref: Para. 22(a))

- A48. The determination of components at which to perform audit work is a matter of professional judgment. Matters that may influence the group auditor's determination include, for example:
- The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example:
    - Newly formed or acquired entities or business units.
    - Entities or business units in which significant changes have taken place.
    - Significant transactions with related parties.
    - Significant transactions outside the normal course of business.
    - Abnormal fluctuations identified by analytical procedures performed at the group level, in accordance with SAS No. 145AU-C section 315ISA 315 (Revised 2019).<sup>53</sup>
  - The disaggregation of significant classes of transactions, account balances and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities and transactions at the location or business unit relative to the group financial statements.

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<sup>53</sup> Paragraph 14(b) of SAS No. 145AU-C section 315ISA 315 (Revised 2019), paragraph 14(b)

- Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances and disclosures in the group financial statements from audit work planned on the financial information of identified components.
- The nature and extent of misstatements or control deficiencies identified at a component in prior period audits.
- The nature and extent of the commonality of controls across the group and whether, and if so, how, the group centralizes activities relevant to financial reporting.

*Considerations Specific to Governmental Entities (Ref: Para. 22)*

A48.1. In audits of governmental entities, matters that may influence the group auditor's determination of components at which to perform audit work include, for example, the disaggregation of significant classes of transactions, account balances and disclosures (e.g., net costs or total budget) in the group financial statements across components, considering the size and nature of assets, liabilities and transactions, at the component unit, business activity, department or program relative to the group financial statements. Qualitative considerations in audits of governmental entities may involve matters of heightened public sensitivity, such as national security issues, donor funded projects, or reporting of tax revenue.

*Resources (Ref: Para. 22(b))*

A49. Matters that influence the group auditor's determination of the resources needed to perform the group audit and the nature, timing and extent to which component auditors are to be involved are a matter of professional judgment and may include, for example:

- The understanding of the group, the components within the group at which audit work is to be performed and whether to perform work centrally, at components or a combination thereof.
- The knowledge and experience of the engagement team. For example, component auditors may have greater experience and a more in-depth knowledge than the group auditor of the local industries in which components operate, local laws or regulations, business practices, language, and culture. In addition, the involvement of auditor's experts-specialists may be needed on complex matters.
- The initial expectations about the potential risks of material misstatement.
- The amount or location of resources to allocate to specific audit areas. For example, the extent to which components are dispersed across multiple locations may impact the need to involve component auditors in specific locations.
- Access arrangements. For example, when the group auditor's access to a component in a particular jurisdiction is restricted, component auditors may need to be involved.
- The nature of the components' activities, including their complexity or specialization of operations.
- The group's system of internal control, including the information system in place, and its degree of centralization. For example, the involvement of component auditors may be more likely when the system of internal control is decentralized.
- Previous experience with the component auditor.

A50. Component auditors may be involved in different phases of an audit, for example, component auditors

may design or perform:

- Risk assessment procedures; and
- Procedures to respond to the assessed risks of material misstatement.

A51. The nature, timing and extent to which component auditors are to be involved depends on the facts and circumstances of the group audit engagement. Often component auditors will be involved in all phases of the audit, but the group auditor may decide to involve component auditors only in a certain phase. When the group auditor does not intend to involve component auditors in risk assessment procedures, the group auditor may still discuss with component auditors whether there are any significant changes in the business or the system of internal control of the component that could have an effect on the risks of material misstatement of the group financial statements.

A52. ~~AU-C section ISA~~ 300<sup>54</sup> requires the engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the group audit. The involvement of component auditors in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The group engagement partner uses professional judgment in determining which component auditors to involve in planning the audit. This may be affected by the nature, timing, and extent to which the component auditors are expected to be involved in designing and performing risk assessment or further audit procedures.

A53. As described in ~~proposed ISQMS~~ 1,<sup>55</sup> there may be circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal or regulatory requirements. The level of fees, including their allocation to component auditors, and the extent to which they relate to the resources required may be a special consideration for group audit engagements. For example, in a group audit, the firm's financial and operational priorities may place constraints on the determination of the components at which audit work will be performed, as well as the resources needed, including the involvement of component auditors. In such circumstances, these constraints do not override the group engagement partner's responsibility for achieving quality at the engagement level or the requirements for the group auditor to obtain sufficient appropriate audit evidence on which to base the group audit opinion.

*Considerations When Component Auditors Are Involved*

Sufficient and Appropriate Involvement in the Work of the Component Auditor (Ref: Para. 23–24)

A54. In evaluating whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor, the group auditor may obtain an understanding of whether the component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor. The group auditor may also obtain an understanding about whether audit evidence related to components located in a different jurisdiction may be in a different language and may need to be translated for use by the group auditor.

<sup>54</sup> ~~Paragraph 5 of AU-C section ISA 300, paragraph 5~~

<sup>55</sup> ~~Paragraph A78 of proposed ISQMS 1, paragraph A74~~

A55. If the component auditor is unable to cooperate with the group auditor, the group auditor may:

- Request the component auditor to provide its rationale.
- Be able to take appropriate action to address the matter, including adjusting the nature of the work requested to be performed. Alternatively, in accordance with paragraph 27, the group auditor may need to obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: Para. 25)

A56. When performing work at a component for a group audit engagement, the component auditor or the referred-to auditor are subject to ethical requirements, including those related to independence, that are relevant to the group audit engagement. Such requirements may be different from or in addition to those applying to the component auditor – or the referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for statutory legal, regulatory, or other reasons in the component auditor's jurisdiction. When the component auditor or the referred-to auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor or referred-to 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 or referred-to auditor's ethical responsibilities in the group audit.

A57. In making the component auditors or the referred-to auditor aware of relevant ethical requirements, the group auditor may consider whether additional information or training for the component auditors or the referred-to auditor is necessary regarding the provisions of the ethical requirements that are relevant to the group audit engagement.

Engagement Resources (Ref: Para. 26)

A58. Proposed QM SAS ISA-220 (Revised)<sup>56</sup> requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. When sufficient or appropriate resources are not made available in relation to work to be performed by a component auditor, the group engagement partner may discuss the matter with the component auditor, group management or the group auditor's firm and may subsequently request the component auditor or the group auditor's firm to make sufficient and appropriate resources available.

Competence and capabilities of the component auditors

A59. Proposed QM SAS ISA-220 (Revised)<sup>57</sup> provides guidance regarding matters the engagement partner may take into consideration when determining the competence and capabilities of the engagement team. This determination is particularly important in a group audit when the engagement team includes component auditors. Proposed QM SAS ISA-220 (Revised)<sup>58</sup> indicates that the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether a component auditor from another firm has the appropriate competence and capabilities to perform the audit engagement.

A60. Determining whether component auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit

<sup>56</sup> Paragraph 25 of proposed QM SAS ISA-220 (Revised), paragraph 25

<sup>57</sup> Paragraph A71 of proposed QM SAS ISA-220 (Revised), paragraph A71

<sup>58</sup> Paragraph A24 of proposed QM SAS ISA-220 (Revised), paragraph A24

engagement. This determination influences the nature, timing and extent of the group engagement partner's direction and supervision of the component auditor and the review of their work.

A61. In determining whether component auditors have the appropriate competence and capabilities to perform the assigned audit procedures at the component, the group engagement partner may consider matters such as:

- Previous experience with or knowledge of the component auditor.
- The component auditor's specialized skills (e.g., industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies).
- The component auditor's understanding of the auditing and other standards applicable to the group audit, such as GAAS that is sufficient to fulfill the component auditor's responsibilities.
- The degree to which the group auditor and component auditor are subject to a common system of quality management, for example, whether the group auditor and a component auditor:
  - Use common resources to perform the work (e.g., audit methodologies or information technology (IT) applications);
  - Share common policies or procedures affecting engagement performance (e.g., direction, supervision and review of work or consultation);
  - Are subject to common monitoring activities; or
  - Have other commonalities, including common leadership or a common cultural environment.
- The consistency or similarity of:
  - Laws or regulations or legal system;
  - Language and culture;
  - Education and training;
  - Professional oversight, discipline, and external quality assurance; or
  - Professional organizations and standards.
- Information obtained about the component auditor through interactions with component management, those charged with governance, and other key personnel, such as internal auditors.

A62. The procedures to determine the component auditor's competency and capability may include, for example:

- An evaluation of the information communicated by the group auditor's firm to the group auditor, including:
  - The firm's ongoing communication related to monitoring and remediation, in

circumstances when the group auditor and component auditor are from the same firm.<sup>59</sup>

- Information from the network about the results of the monitoring activities undertaken by the network across the network firms.<sup>60</sup>
- Information obtained from professional body(ies) to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.
- Discussing the assessed risks of material misstatement with the component auditor.
- Requesting the component auditor to confirm their understanding of the matters referred to in paragraph 25 in writing.
- Discussing the component auditor’s competence and capabilities with colleagues in the group engagement partner’s firm that have worked directly with the component auditor.
- Obtaining published external inspection reports, peer review reports on the component auditor’s firm and other relevant publicly available information relating to the professional reputation and standing of a component auditor.

A63. The group engagement partner’s firm and the component auditor may be members of the same network and may be subject to common network requirements or use common network services.<sup>61</sup> When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such network requirements, for example, those addressing professional training, or recruitment or that require the use of audit methodologies and related implementation tools. In accordance with proposed ISQMS 1,<sup>62</sup> the firm is responsible for designing, implementing, and operating its system of quality management, and the firm may need to adapt or supplement network requirements or network services to be appropriate for use in its system of quality management.

Using the work of an auditor’s expertspecialist

A64. Proposed QM SAS ISA 220 (Revised)<sup>63</sup> requires the engagement partner to determine that members of the engagement team, and any auditor’s external specialistsexperts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. If an auditor’s expert-specialist is used by a component auditor, the group engagement partner may need to obtain information from the component auditor. For example, the group auditor may discuss with the component auditor, the component auditor’s evaluation of the competence and capabilities of the auditor’s specialist.

Automated tools and techniques

A65. When determining whether the engagement team has the appropriate competence and capabilities, the group engagement partner may take into consideration such matters as the expertise of the component auditor in the use of automated tools and techniques. For example, as described in

<sup>59</sup> Paragraph 48 of proposed ISQMS 1, paragraph 47

<sup>60</sup> Paragraph 52(b) of proposed ISQMS 1, paragraph 51(b)

<sup>61</sup> Paragraphs A20 and A187 of Proposed ISQMS 1, paragraphs A19, A175

<sup>62</sup> Paragraphs 49-50 of proposed ISQMS 1, paragraph 48-49

<sup>63</sup> Paragraph 26 of proposed QM SAS ISA 220 (Revised), paragraph 26

~~proposed QM SAS ISA 220 (Revised)~~,<sup>64</sup> when the group auditor requires component auditors to use specific automated tools and techniques when performing audit procedures, the group auditor may communicate with component auditors that the use of such automated tools and techniques need to comply with the group auditor's instructions.

Application of the Group Auditor's Understanding of a Component Auditor (Ref: Para. 27)

A66. ~~Proposed QM SAS ISA 220 (Revised)~~<sup>65</sup> requires the engagement partner to take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures. This includes the firm's policies or procedures that address circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches. The firm's policies or procedures also may address breaches of independence requirements by component auditors, and actions the group auditor may take in those circumstances in accordance with the relevant ethical requirements. In addition, relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances when breaches of independence requirements have been identified.<sup>66</sup>

A67. If there has been a breach by a component auditor or a referred-to auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot use the work of that component auditor or make reference in the auditor's report on the group financial statements to the audit of that auditor.

A68. Serious concerns are those concerns that in the group auditor's professional judgment cannot be overcome. The group engagement partner may be able to overcome less than serious concerns about the component auditor's or the referred-to auditor's professional competency (e.g., lack of industry-specific knowledge), or the fact that the component auditor or referred-to auditor does not operate in an environment that actively oversees auditors, ~~by the group auditor being more involved in the work of the component auditor or~~ by directly performing further audit procedures on the financial information of the component, or by the group auditor being more involved in the work of the component auditor, or by making reference in the auditor's report on the group financial statements to the audit of that e referred-to auditor.

Engagement Performance (Ref: Para. 28)

A69. ~~Proposed QM SAS ISA 220 (Revised)~~<sup>67</sup> requires the engagement partner to determine that the nature, timing, and extent of direction, supervision, and review is planned and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements, and is responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team. For a group audit, the approach to direction, supervision and review will generally include a combination of addressing the group auditor's firm policies or procedures and group audit engagement specific responses.

A70. For a group audit, particularly when the engagement team includes a large number of component auditors that may be located in multiple locations, the group engagement partner may assign the

<sup>64</sup> ~~Paragraph A65 of proposed QM SAS ISA 220 (Revised), paragraph A65~~

<sup>65</sup> ~~Paragraph 17 of proposed QM SAS ISA 220 (Revised), paragraph 17~~

<sup>66</sup> ~~Paragraph A17 of AU-C section ISA 260 (Revised), paragraph A34~~

<sup>67</sup> ~~Paragraph 30 of proposed QM SAS ISA 220 (Revised), paragraph 30~~

design or performance of procedures, tasks, or actions to other members of the engagement team to assist the group engagement partner in fulfilling the responsibility for the nature, timing and extent of the direction and supervision of component auditors and the review of their work. (see also paragraph 11).

- A71. If component auditors are from a firm other than the group auditor’s firm, the firm’s policies or procedures may be different, or different actions may need to be taken, respectively, in relation to the nature, timing and extent of direction and supervision of those members of the engagement team, and the review of their work. In particular, firm policies or procedures may require the firm or the group engagement partner to take different actions from those applicable to members of the engagement team within the firm or the network (e.g., in relation to the form, content and timing of communications with component auditors, including the use of group auditor instructions to component auditors). ~~Proposed QM SAS ISA 220 (Revised)~~ provides examples of actions that may need to be taken in such circumstances.<sup>68</sup>
- A72. The nature, timing and extent of direction and supervision of component auditors and review of their work may be tailored based on the nature and circumstances of the engagement and, for example:
- The assessed risks of material misstatement. For example, if the group auditor has identified a component that includes a significant risk, an increase in the extent of direction and supervision of the component auditor and a more detailed review of the component auditor’s audit documentation may be appropriate.
  - The competence and capabilities of the component auditors performing the audit work. For example, if the group auditor has no previous experience working with a component auditor, the group auditor may communicate more detailed instructions, increase the frequency of discussions or other interactions with the component auditor, or assign more experienced individuals to oversee the component auditor as the work is performed.
  - The location of engagement team members, including the extent to which engagement team members are dispersed across multiple locations, including when service delivery centers are used.
  - Access to component auditor audit documentation. For example, when law or regulation precludes component auditor audit documentation from being transferred out of the component auditor’s jurisdiction, the group auditor may be able to review the audit documentation at the component auditor’s location or remotely through the use of technology, when not prohibited by law or regulation (see also paragraphs A176–A177).
- A73. There are different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work, for example:
- Communications with component auditors throughout the course of the group audit, including communications required by this ~~proposed SAS~~ISA;
  - Meetings or calls with component auditors to discuss identified and assessed risks, issues, findings, and conclusions.

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<sup>68</sup> ~~Paragraphs A24–A25 of proposed QM SAS~~ISA 220 (Revised), paragraph A24–A25

- Reviews of the component auditor's audit documentation in person or remotely when permitted by law and regulation.
- Participating in the closing or other key meetings between the component auditors and component management.

A74. In applying ~~proposed QM SAS ISA 220 (Revised)~~,<sup>69</sup> the group engagement partner is required to review audit documentation at appropriate points in time during the audit engagement, including audit documentation relevant to the group audit relating to:

- Significant matters;
- Significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
- Other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

The review of such audit documentation by the group engagement partner often takes place during the course of the group audit, including the review of relevant component auditor audit documentation (also see paragraph A145).

*Communications with Component Auditors* (Ref: Para. 29)

A75. Clear and timely communication between the group auditor and the component auditors about their respective responsibilities, along with clear direction to the component auditors about the nature, timing, and extent of the work to be performed and the matters expected to be communicated to the group auditor, helps establish the basis for effective two-way communication. Effective two-way communication between the group auditor and the component auditors also helps to set expectations for component auditors and facilitates the group auditor's direction and supervision of them and the review of their work. Such communication also provides an opportunity for the group engagement partner to reinforce the need for component auditors to exercise professional skepticism in the work performed for purposes of the group audit.

A76. Other factors that may also contribute to effective two-way communication include:

- Clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies or procedures of the group auditor's firm.
- A mutual understanding that the component auditor may discuss the audit work requested to be performed, based on the component auditor's knowledge and understanding of the component.
- A mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form of communications. For example, matters that need timely attention may be more appropriately discussed in a meeting rather than by exchanging emails.

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<sup>69</sup> ~~Paragraphs 31 and A92-A93 of proposed QM SAS ISA 220 (Revised), paragraphs 31, A92-A93~~

- A mutual understanding of the person(s) from the group auditor and component auditors who have responsibility for managing communications regarding particular matters.
- The process for the component auditor to take action and report back on matters communicated by the group auditor.

A77. The communications between the group auditor and component auditors depend on the facts and circumstances of the group audit engagement, including the nature and extent of involvement of the component auditors and the degree to which the group auditor and component auditors are subject to common systems of quality management or common network requirements or network services.

#### Form of communications

A78. The form of the communications between the group auditor and component auditors may vary based on factors such as the nature of the audit work the component auditors have been requested to perform, and the extent to which communication capabilities are integrated into the audit tools used for the group audit.

A79. The form of communications also may be affected by such factors as:

- The significance, complexity, or urgency of the matter.
- Whether the matter has been or is expected to be communicated to group management and those charged with governance of the group.
- Whether the group auditor and component auditor are from the same firm or network firms.

A80. Communication between the group auditor and the component auditor may not necessarily be in writing. However, the group auditor's verbal communications with the component auditors may be supplemented by written communication, such as a set of instructions regarding the work to be performed, when the group auditor wants to give particular attention to, or promote a mutual understanding about, certain matters. In addition, the group auditor may meet with the component auditor to discuss significant matters or to review relevant parts of the component auditor's audit documentation.

A81. Paragraph 45 requires the group auditor to request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. As explained in paragraph A144, the form and content of the component auditor's deliverables are influenced by the nature and extent of the audit work the component auditor has been requested to perform.

A82. Regardless of the form of communication, the documentation requirements of this proposed SAS and other AU-C sections ~~ISAs~~ apply.

#### Timing of communications

A83. The appropriate timing of communications will vary with the circumstances of the engagement. Relevant circumstances may include the nature, timing, and extent of work to be performed by the component auditor and the action expected to be taken by the component auditor. For example, communications regarding planning matters may often be made early in the audit engagement and, for an initial group audit, may be made as part of agreeing the terms of the engagement.

Non-compliance with laws or regulations (Ref: Para. 25, 29)

A84. In applying ~~AU-C section ISA 250 (Revised)~~,<sup>70</sup> the group engagement partner may become aware of information about non-compliance or suspected non-compliance with laws or regulations. In such circumstances, the group engagement partner may have an obligation under relevant ethical requirements, laws or regulations, to communicate the matter to the component auditor or referred-to auditor.<sup>71</sup> The obligation of the group engagement partner to communicate non-compliance or suspected non-compliance may extend to auditors of the financial statements of entities or business units for which an audit is required by ~~statute, law or~~ regulation or performed for another reason, but for which no audit work is performed for purposes of the group audit.

**Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control** (Ref: Para. 30)

A85. ~~AU-C section 315 ISA 315 (Revised 2019)~~<sup>72</sup> contains requirements and guidance regarding the auditor's responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. Appendix 2 of this proposed SAS provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how ~~AU-C section 315 ISA 315 (Revised 2019)~~ is to be applied to an audit of group financial statements.

A85.1. The group auditor's understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal controls with respect to the components for which a referred-to auditor performs an audit may vary as compared to the components for which a component auditor performs audit procedures.

A86. The understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control may be obtained through communications with:

- Group management, component management or other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) and individuals who have knowledge of the group's system of internal control, accounting policies and practices, and the consolidation process;
- Component auditors or referred-to auditors; or
- Auditors that perform an audit for legal ~~statutory~~, regulatory, or other reasons of the financial statements of an entity or business unit that is part of the group.

A87. Obtaining an understanding of the group, identifying risks of material misstatement and assessing inherent risk and control risk may be performed in different ways depending on preferred audit

<sup>70</sup> ~~AU-C section ISA 250 (Revised)~~, *Consideration of Laws and Regulations in an Audit of Financial Statements*

<sup>71</sup> See, for example, paragraphs 22–23 of the proposed "Responding to Noncompliance With Laws and Regulations" interpretation of the AICPA Code of Professional Conduct Section R360.17 and Section R360.18 of the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code)

<sup>72</sup> Paragraphs 19–31 and A58–A212 of AU-C section 315 ISA 315 (Revised 2019), paragraphs 19–27, A50–A183

techniques or methodologies and may be expressed in different ways. Accordingly, when component auditors are involved in the design and performance of risk assessment procedures, the group auditor may need to communicate its preferred approach with component auditors or provide instructions.

*Engagement Team Discussion* (Ref: Para. 30)

A88. In applying ~~AU-C section 315~~~~ISA 315 (Revised 2019)~~,<sup>73</sup> the group engagement partner and other key engagement team members are required to discuss the application of the applicable financial reporting framework and the susceptibility of the group's financial statements to material misstatement. The group engagement partner's determination of which members of the engagement team to include in the discussion and the topics to be discussed, is affected by matters such as initial expectations about the risks of material misstatement and the preliminary expectation of whether to involve component auditors.

A89. The discussion provides an opportunity to:

- Share knowledge of the components and their environments, including which components' activities are centralized.
- Exchange information about the business risks of the components or the group, and how inherent risk factors may affect susceptibility to misstatement of classes of transactions, account balances and disclosures.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. ~~AU-C section~~~~ISA 240~~<sup>74</sup> requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.
- Identify policies followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting.
- Consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.
- Consider the risk that group or component management may override controls.
- Discuss fraud that has been identified, or information that indicates existence of a fraud.
- Identify risks of material misstatement relevant to components where there may be impediments to the exercise of professional skepticism.
- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).

<sup>73</sup> ~~Paragraph 17 of SAS No. 145~~~~AU-C section 315~~~~ISA 315 (Revised 2019), paragraph 17~~

<sup>74</sup> ~~Paragraph 16 of AU-C section~~~~ISA 240, paragraph 16~~

- Share information about risks of material misstatement of the financial information of a component that may apply more broadly to some, or all, of the other components.
- Share information that may indicate non-compliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices.
- Discuss events or conditions identified by group management, component management or the engagement team, that may cast significant doubt on the group's ability to continue as a going concern.
- Discuss related party relationships or transactions identified by group management or component management, and any other related parties of which the engagement team is aware.

*The Group and Its Environment* (Ref: Para. 30 (a))

A90. An understanding of the group's organizational structure and its business model may enable the group auditor to understand such matters as:

- The complexity of the group's structure. A group may be more complex than a single entity because a group may have several subsidiaries, divisions, or other business units, including in multiple locations. Also, a group's legal structure may be different from the operating structure, for example, for tax purposes. Complex structures often introduce factors that may give rise to increased susceptibility to material misstatements, such as whether goodwill, joint ventures or special purpose entities are accounted for appropriately and whether adequate disclosures have been made.
- The geographic locations of the group's operations. Having a group that is located in multiple geographical locations may give rise to increased susceptibility to material misstatements. For example, different geographical locations may involve different languages, cultures, and business practices.
- The structure and complexity of the group's IT environment. A complex IT environment often introduces factors that may give rise to increased susceptibility to material misstatements. For example, a group may have a complex IT environment because of multiple IT systems that are not integrated due to recent acquisitions or mergers. Therefore, it may be particularly important to obtain an understanding of the complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment. A group may also use one or more external service providers for aspects of its IT environment.
- Relevant regulatory factors, including the regulatory environment. Different laws or regulations may introduce factors that may give rise to increased susceptibility to material misstatements. A group may have operations that are subject to a high degree of complex laws or regulations in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.
- The ownership, and relationships between owners and other people or entities, including related parties. Understanding the ownership and relationships can be more complex in a group that operates across multiple jurisdictions and when there are changes in ownership through formation, acquisition, disposal, or joint venture. These factors may give rise to

increased susceptibility to material misstatements.

- A91. Obtaining an understanding of the degree to which the group's operations or activities are similar may help to identify similar risks of material misstatement across components and design an appropriate response.
- A92. The financial results of entities or business units are ordinarily measured and reviewed by group management. Inquiries of group management may reveal that group management relies on certain key indicators to evaluate the financial performance of the group's entities and business units and take action. The understanding of such performance measures may help to identify:
- Areas where there is increased susceptibility to material misstatements (e.g., due to pressures on component management to meet certain performance measures).
  - Controls over the group's financial reporting process.

#### *The Group's System of Internal Control*

The Nature and Extent of Commonality of Controls (Ref: Para. 30(c)(i))

- A93. Group management may design controls that are intended to operate in a common manner across multiple entities or business units (i.e., common controls). For example, group management may design common controls for inventory management, which operate using the same IT system and that are implemented across all entities or business units in the group. Common controls may exist in each component of the group's system of internal control, and they may be implemented at different levels within the group (e.g., at the level of the consolidated group as a whole, or for other levels of aggregation within the group). Common controls may be direct controls or indirect controls. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that support direct controls.<sup>75</sup>
- A94. Understanding the components of the group's system of internal control includes understanding the commonality of tasks and actions, structures, processes, or the controls within those components across the group.

In understanding the commonality of a control across the group, considerations that may be relevant include whether:

- The control is designed centrally and is required to be implemented as designed (i.e., without modification) at some or all components;
- The control is implemented and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components where the control is implemented;
- If a control uses information from IT applications, the IT applications and other aspects of the IT environment that generate the information are the same across the components or locations; or
- If the control is automated, it is configured in the same way in each IT application across the components.

<sup>75</sup> Paragraph A5 of AU-C section 315~~ISA 315 (Revised 2019), paragraph A5~~

- A96. Judgment may often be needed to determine whether a control is a common control. For example, group management may require that all entities and business units perform a monthly evaluation of the aging of customers' accounts that are generated from a specific IT application. When the aging reports are generated from different IT applications or the implementation of the IT application differs across entities or business units, there may be a need to consider whether the control can be determined to be common. This is because of differences in the design of the control that may exist due to the existence of different IT applications (e.g., whether the IT application is configured in the same manner across components, and whether there are effective general IT controls across different IT applications).
- A97. Consideration of the level at which controls are performed within the group (e.g., at the level of the consolidated group as a whole or for other levels of aggregation within the group) and the degree of centralization and commonality may be important to the understanding of how information is processed and controlled. In some circumstances, controls may be performed centrally (e.g., performed only at a single entity or business unit), but may have a pervasive effect on other entities or business units (e.g., a shared service center that processes transactions on behalf of other entities or business units within the group). The processing of transactions and related controls at a shared service center may operate in the same way for those transactions being processed by the shared service center regardless of the entity or business unit (e.g., the processes, risks and controls may be the same regardless of the source of the transaction). In such cases, it may be appropriate to identify the controls and evaluate the design and determine the implementation of the controls, and, if applicable, test operating effectiveness, as a single population.

Centralized Activities (Ref: Para. 30(c)(i)–(ii))

- A98. Group management may centralize some of its activities, for example financial reporting or accounting functions may be performed for a particular group of common transactions or other financial information in a consistent and centralized manner for multiple entities or business units (e.g., when the initiation, authorization, recording, processing, or reporting of revenue transactions is performed at a shared service center).
- A99. Obtaining an understanding of how centralized activities fit into the overall group structure, and the nature of the activities undertaken, may help to identify and assess risks of material misstatement and appropriately respond to such risks. For example, controls at a shared service center may operate independently from other controls, or they may be dependent upon controls at an entity or business unit from which financial information is derived (e.g., sales transactions may be initiated and authorized at an entity or business unit, but the processing may occur at the shared service center).
- A100. The group auditor may involve component auditors in testing the operating effectiveness of common controls or controls related to centralized activities. In such circumstances, effective collaboration between the group auditor and component auditors is important as the audit evidence obtained through testing the operating effectiveness of common controls or controls related to centralized activities supports the determination of the nature, timing, and extent of substantive procedures to be performed across the group.

Communications About Significant Matters that Support the Preparation of the Group Financial Statements (Ref: Para. 30(c)(iv))

- A101. Group entities or business units may use a financial reporting framework for statutory legal, regulatory, or other reasons that is different from the financial reporting framework used for the group's financial statements. In such circumstances, an understanding of group management's financial reporting processes to align accounting policies and, when relevant, financial reporting period-ends that differ from that of the group, enables the group auditor to understand how adjustments, reconciliations and

reclassifications are made, and whether they are made centrally by group management or by the entity or business unit.

Instructions by group management to entities or business units

A102. In applying ~~AU-C section 315~~ISA 315 (Revised 2019),<sup>76</sup> the group auditor is required to understand how group management communicates significant matters that support the preparation of the group financial statements. To achieve uniformity and comparability of financial information, group management may issue instructions (e.g., communicate financial reporting policies) to the entities or business units that include details about financial reporting processes or may have policies that are common across the group. Obtaining an understanding of group management's instructions may affect the identification and assessment of the risks of material misstatement of the group financial statements. For example, inadequate instructions may increase the likelihood of misstatements due to the risk that transactions are incorrectly recorded or processed, or that accounting policies are incorrectly or inconsistently applied.

A103. The group auditor's understanding of the instructions or policies may include the following:

- The clarity and practicality of the instructions for completing the reporting package.
- Whether the instructions:
  - Adequately describe the characteristics of the applicable financial reporting framework and the accounting policies to be applied;
  - Address information necessary to prepare disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example, disclosure of related party relationships and transactions, and segment information;
  - Address information necessary for making consolidation adjustments, for example, intra-group transactions and unrealized profits, and intra-group account balances; and
  - Include a reporting timetable.

*Considerations When Component Auditors Are Involved* (Ref: Para. 31–32, 41)

A104. During the course of the group audit, the group auditor may communicate the matters in paragraph 31 to other component auditors, if these matters are relevant to the work of those component auditors. Paragraph A142 includes examples of other matters that may need to be communicated timely in the course of the component auditor's work.

A105. The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.<sup>77</sup> In a group audit there may be a higher risk of material misstatement of the group financial statements, including due to fraud, associated with related party relationships when:

- The group structure is complex;
- The group's information systems are not integrated and therefore less effective in identifying and recording related party relationships and transactions; and
- There are numerous or frequent related party transactions between entities and business units.

<sup>76</sup> ~~Paragraph 25(b) of AU-C section 315~~ISA 315 (Revised 2019), paragraph 25(b)

<sup>77</sup> ~~Paragraph 3 of AU-C section~~ ISA 550, paragraph 2

Planning and performing the audit with professional skepticism, as required by [AU-C section ISA 200](#),<sup>78</sup> is therefore particularly important when these circumstances exist.

**Identifying and Assessing the Risks of Material Misstatement** (Ref: Para. 34)

A106. The process to identify and assess the risks of material misstatement of the group financial statements is iterative and dynamic, and may be challenging, particularly when the component's activities are complex or specialized, or when there are many components across multiple locations. In applying [AU-C section 315](#)~~ISA 315 (Revised 2019)~~,<sup>79</sup> the auditor develops initial expectations about the potential risks of material misstatement and an initial identification of the significant classes of transactions, account balances and disclosures of the group financial statements based on their understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control.

A107. The initial expectations about the potential risks of material misstatement take into account the auditor's understanding of the group, including its entities or business units, and the environments and industries in which they operate. Based on the initial expectations, the group auditor may, and often will, involve component auditors in risk assessment procedures as they may have direct knowledge and experience with the entities or business units that may be helpful in understanding the activities and related risks, and where risks of material misstatement of the group financial statements may arise in relation to those entities or business units.

A108. For identified risks of material misstatement at the assertion level, the group auditor is required to take responsibility for assessing inherent risk. Such assessment involves assessing the likelihood and magnitude of misstatement, which takes into account how, and the degree to which:<sup>80</sup>

- Inherent risk factors affect the susceptibility of relevant assertions to misstatement.
- The risks of material misstatement at the group financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.

A109. Based on the risk assessment procedures performed, the group auditor may determine that an assessed risk of material misstatement of the group financial statements only arises in relation to financial information of certain components. For example, the risk of material misstatement relating to a legal claim may only exist in entities or business units that operate in a certain jurisdiction or in entities or business units that have similar operations or activities.

A110. Appendix 3 sets out examples of events and conditions that, individually or together, may indicate risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process.

*Fraud*

A111. In applying [AU-C section ISA 240](#),<sup>81</sup> the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material

<sup>78</sup> [Paragraph 18 of AU-C section ISA 200](#), ~~paragraph 15~~

<sup>79</sup> [Paragraph A143 of AU-C section 315](#)~~ISA 315 (Revised 2019)~~, ~~paragraph A126~~

<sup>80</sup> [Paragraph 35 of AU-C section 315](#)~~ISA 315 (Revised 2019)~~, ~~paragraph 34~~

<sup>81</sup> [Paragraphs 26 and 31 of AU-C section ISA 240](#), ~~paragraphs 26, 34~~

misstatement of the group financial statements due to fraud may include the following:

- Group management’s assessment of the risk that the group financial statements may be materially misstated due to fraud.
- Group management’s process for identifying and responding to the risks of fraud in the group financial statements, including any specific fraud risks identified by group management, or classes of transactions, account balances, or disclosures for which a risk of fraud is higher.
- Whether there are particular components which are more susceptible to risks of material misstatement due to fraud.
- Whether any fraud risk factors or indicators of management bias exist in the consolidation process.
- How those charged with governance of the group monitor group management’s processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and when appropriate, component management, the component auditors, and others) to the group auditor’s inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.

*Considerations When Component Auditors Are Involved* (Ref: Para. 34)

A112. When the group auditor involves component auditors in the design and performance of risk assessment procedures, the group auditor remains responsible for having an understanding of the group and its environment, the applicable financial reporting framework and the group’s system of internal control to have a sufficient basis for the identification and assessment of the risks of material misstatement of the group financial statements in accordance with paragraph 33.

A113. When the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement, [AU-C section 315](#)~~ISA 315 (Revised 2019)~~<sup>82</sup> requires the auditor to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

## Materiality

*Component Performance Materiality* (Ref: Para. 35(a))

A114. Paragraph 35(a) requires the group auditor to determine component performance materiality for each of the components where [the group auditor or component auditor will perform](#) audit procedures ~~are performed~~ on financial information that is disaggregated. The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.

[A114.1 This proposed SAS does not require component performance materiality to be determined for components that are audited by referred-to auditors and for which the group auditor plans to make](#)

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<sup>82</sup> [Paragraph 39 of AU-C section 315](#)~~ISA 315 (Revised 2019)~~, paragraph 35

reference to in the auditor's report on the group financial statements.

A115. This ~~proposed SAS~~ISA does not require component performance materiality to be determined for each class of transactions, account balance or disclosure for components at which audit procedures are performed. However, if, in the specific circumstances of the group, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, AU-C section ISA 320<sup>83</sup> requires a determination of the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. In these circumstances, the group auditor may need to consider whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate for those particular classes of transactions, account balances or disclosures.<sup>84</sup>

A116. The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the group auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (e.g., as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (e.g., if a single component represents a large portion of the group, there likely may be less disaggregation across components).
- Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example:
  - Whether there are risks that are unique to the financial information of the component (e.g., industry-specific accounting matters, unusual or complex transactions).
  - The nature and extent of misstatements identified at the component in prior audits.

A117. To address aggregation risk, paragraph 35(a) requires component performance materiality to be lower than group performance materiality. As explained in paragraph A116, as the extent of disaggregation across components increases, a lower component performance materiality amount ordinarily would be appropriate to address aggregation risk. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality because there is less aggregation risk, such as when the financial information for one component represents a substantial portion of the group financial statements. When determining component performance materiality for a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may take into account the group's ownership percentage and the share of the investee's profits and losses.

A118. In some cases, further audit procedures may be performed by the group auditor or a component auditor on a significant class of transactions or significant account balance as a single population (i.e., not disaggregated across components). In such cases, group performance materiality often will

<sup>83</sup> Paragraphs 10 and A14-A15 of AU-C section ISA 320, paragraphs 10 and A11-A12

<sup>84</sup> Paragraph A17 of AU-C section ISA 320, paragraph A13

be used for purposes of performing these procedures.

A118.1 When the component is subject to an audit required by law or regulation or performed for another reason, the performance materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group performance materiality and, accordingly, be acceptable for purposes of the group audit.

*'Clearly Trivial' Threshold (Ref: Para: 35(b))*

A119. The threshold for communicating misstatements to the group auditor is set at an amount equal to, or lower than, the amount regarded as clearly trivial for the group financial statements. In accordance with AU-C section ISA 450,<sup>85</sup> this threshold is the amount below which misstatements would not need to be accumulated because the group auditor expects that the accumulation of such amounts clearly would not have a material effect on the group financial statements.

#### *Considerations When Component Auditors Are Involved*

Communicating Component Performance Materiality (Ref: Para. 36)

A120. In some cases, it may be appropriate for the group auditor to involve the component auditor in determining an appropriate component performance materiality amount, in view of the component auditor's knowledge of the component and potential sources of misstatement of the component financial information. In this regard, the group auditor also may consider communicating group performance materiality to the component auditor to support collaboration in determining whether component performance materiality, in relation to group performance materiality, is appropriate in the circumstances.

A121. Component performance materiality is based, at least in part, on expectations about the nature, frequency, and magnitude of misstatements in the component financial information. Therefore, ongoing communication between the component auditor and the group auditor is important, particularly if the number and magnitude of misstatements identified by the component auditor are higher than expected.

#### **Responding to the Assessed Risks of Material Misstatement (Ref: Para. 37)**

##### *Performing Further Audit Procedures*

Performing Further Audit Procedures Centrally

A122. Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally (e.g., at a shared service center). Factors that may be relevant to the auditor's determination of whether to perform further audit procedures centrally include, for example:

- The level of centralization of activities relevant to financial reporting.
- The nature and extent of commonality of controls.
- The similarity of the group's activities and business lines.

A123. The group auditor may determine that the financial information of several components can be

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<sup>85</sup> Paragraph A6 of AU-C section ISA 450, paragraph A3

considered as one population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogenous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way.

A124. When further audit procedures are performed centrally, component auditors may still be involved. For example, when the group has multiple shared service centers, the group auditor may involve component auditors in the performance of further audit procedures for these shared service centers.

#### Performing Further Audit Procedures at the Component Level

A125. In other circumstances, procedures to respond to the risks of material misstatement of the group financial statements that are related to the financial information of a component may be more effectively performed at the component level. This may be the case when the group has:

- Different revenue streams;
- Multiple lines of business;
- Operations across multiple locations; or
- Decentralized systems of internal control.

#### Large Number of Components Whose Financial Information Is Individually Immaterial but Material in the Aggregate to the Group Financial Statements

A126. A group may be comprised of a large number of components whose financial information is individually immaterial but material in the aggregate to the group financial statements. Circumstances such as these in which the significant classes of transactions, account balances or disclosures in the group financial statements are disaggregated over a large number of components may present additional challenges for the group auditor in planning and performing further audit procedures.

A127. In some cases, it may be possible to obtain sufficient appropriate audit evidence by performing further audit procedures centrally on these significant classes of transactions, account balances or disclosures (e.g., if they are homogeneous, subject to common controls and access to appropriate information can be obtained). The further audit procedures may also include substantive analytical procedures in accordance with [AU-C section ISA 520](#).<sup>86</sup> Depending on the circumstances of the engagement, the financial information of the components may be aggregated at appropriate levels for purposes of developing expectations and determining the amount of any difference of recorded amounts from expected values in performing the substantive analytical procedures. The use of automated tools and techniques may be helpful in these circumstances.

A128. In other cases, it may be necessary to perform further audit procedures at selected components to address the risks of material misstatement of the group financial statements. The determination of the components at which audit procedures are to be performed, and the nature, timing, and extent of further audit procedures to be performed at the selected components, are matters of professional judgment. In these circumstances, introducing an element of unpredictability in the components selected for testing also may be helpful in

<sup>86</sup> [AU-C section ISA 520](#), *Analytical Procedures*

relation to the risks of material misstatement of the group financial statements due to fraud (also see paragraph A134).

*The Nature and Extent of Further Audit Procedures*

A129. In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):

- Design and perform further audit procedures on the entire financial information of the component;
- Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures; or
- Perform specific further audit procedures.

A130. Although the group auditor takes responsibility for the nature, timing, and extent of further audit procedures to be performed, component auditors can be, and often are, involved in all phases of the group audit, including in the design and performance of further audit procedures.

A130.1. The group auditor may determine that obtaining the audit report of a referred-to auditor with respect to one or more components may be appropriate audit evidence. In that case, the group auditor makes reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.

*Design and Perform Further Audit Procedures on the Entire Financial Information of the Component*

A131. The group auditor may determine that designing and performing further audit procedures on the entire financial information of a component is an appropriate approach, including when:

- Audit evidence needs to be obtained on all or a significant proportion of a component's financial information to respond to the assessed risks of material misstatement of the group financial statements.
- There is a pervasive risk of material misstatement of the group financial statements due to the existence of events or conditions at the component that may be relevant to the group auditor's evaluation of group management's assessment of the group's ability to continue as a going concern.

*Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures*

A132. The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but holds a significant portion of the land and buildings of the group or has significant tax balances.

Perform specific further audit procedures

A133. The group auditor may determine that designing and performing specific further audit procedures on the financial information of a component is an appropriate approach, such as when audit evidence needs to be obtained for one or more relevant assertions only. For example, the group auditor may centrally test the class of transaction, account balance or disclosure and may require the component auditor to perform specific further audit procedures at the component (e.g., specific further audit procedures related to the valuation of claims or litigations in the component's jurisdiction or the existence of an asset).

*Element of Unpredictability*

A134. Incorporating an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed and the extent to which the group auditor is involved in the work, may increase the likelihood of identifying a material misstatement of the components' financial information that may give rise to a material misstatement of the group financial statements due to fraud.<sup>87</sup>

*Operating Effectiveness of Controls*

A135. The group auditor may rely on the operating effectiveness of controls that operate throughout the group in determining the nature, timing, and extent of substantive procedures to be performed at either the group level or at the components. ~~AU-C section ISA~~ 330<sup>88</sup> requires the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of those controls. Component auditors may be involved in designing and performing such tests of controls.

A136. If deviations from controls upon which the auditor intends to rely are detected, ~~AU-C section ISA~~ 330<sup>89</sup> requires the auditor to make specific inquiries to understand these matters and their potential consequences. If more deviations than expected are detected as a result of testing the operating effectiveness of the controls, the group auditor may need to revise the group audit plan. Possible revisions to the group audit plan may include:

- ~~Requesting Performing~~ additional substantive procedures ~~to be performed~~ at certain components.
- Identifying and testing the operating effectiveness of other relevant controls that are designed and implemented effectively.
- Increasing the number of components selected for further audit procedures.

A137. When the operating effectiveness of controls is tested centrally (e.g., controls at a shared service center or testing of common controls), the group auditor may need to communicate information about the audit work performed to the component auditors. For example, when a component auditor is requested to design and perform substantive procedures on the entire financial information of the component, or design and perform substantive procedures on one or more classes of transactions, account balances or disclosures, the component auditor may discuss with the group auditor about the control testing performed centrally to determine the nature, timing, and extent of the substantive procedures.

<sup>87</sup> ~~Paragraph 29c of AU-C section ISA 240, paragraph 30(e)29c~~

<sup>88</sup> ~~Paragraph 8 of AU-C section ISA 330, paragraph 8~~

<sup>89</sup> ~~Paragraph 17 of AU-C section ISA 330, paragraph 17~~

*Consolidation Process*

Consolidation Procedures (Ref: Para. 38(a))

A138. The further audit procedures on the consolidation, including sub-consolidations, may include:

- Determining that the necessary journal entries are reflected in the consolidation; and
- Evaluating the operating effectiveness of the controls over the consolidation process and responding appropriately if any controls are determined to be ineffective.

Consolidation Adjustments and Reclassifications (Ref: Para. 38(c))

A139. The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements that do not pass through the usual IT applications, and may not be subject to the same controls to which other financial information is subject. The group auditor's evaluation of the appropriateness, completeness and accuracy of the adjustments and reclassifications may include:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;
- Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included;
- Determining whether significant adjustments have been correctly calculated, processed and authorized by group management and, when applicable, by component management;
- Determining whether significant adjustments are properly supported and sufficiently documented; and
- Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits or losses, and intra-group account balances.

*Considerations When Component Auditors Are Involved* (Ref: Para. 42–43)

A140. When the group auditor involves component auditors in the design or performance of further audit procedures, the component auditor may determine that the use of the work of an auditor's ~~expert~~ specialist is appropriate and communicate this to the group auditor. In such circumstances, when determining whether the component auditor's design and performance of further audit procedures is appropriate, the group auditor may, for example, discuss with the component auditor:

- -The nature, scope and objectives of the auditor's specialist's work.
- The component auditor's evaluation of the adequacy of the work of the auditor's ~~specialist~~expert for the group auditor's purposes.

A141. The appropriate level of the group auditor's involvement may depend on the circumstances and the structure of the group and other factors, such as the group auditor's previous experience with the component auditors that perform procedures on the consolidation and sub-consolidations and the circumstances of the group audit engagement (e.g., if the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements).

## **Evaluating the Component Auditor’s Communication and the Adequacy of Their Work**

*Communication about Matters Relevant to the Group Auditor’s Conclusion with Regard to the Group Audit* (Ref: Para. 45)

A142. Although the matters required to be communicated in accordance with paragraph 45 are relevant to the group auditor’s conclusion with regard to the group audit, certain matters may be communicated during the course of the component auditor’s procedures. In addition to the matters in paragraphs 32 and 50, such matters may include, for example:

- Information about breaches of relevant ethical requirements, including identified breaches of independence provisions;
- Information about instances of non-compliance with laws or regulations;
- Newly arising significant risks of material misstatement, including risks of fraud;
- Identified or suspected fraud or illegal acts involving component management or employees that could have a material effect on the group financial statements; or
- Significant and unusual transactions.

*Communication of Misstatements of Component Financial Information* (Ref: Para. 45(e))

A143. Knowledge about corrected and uncorrected misstatements across components may alert the group auditor to potential pervasive internal control deficiencies, when considered along with the communication of deficiencies in accordance with paragraph 45(g). In addition, a higher than expected number of identified misstatements (uncorrected or corrected) may indicate a higher risk of undetected misstatements, which may lead the group auditor to conclude that additional audit procedures need to be performed at certain components.

*Component Auditor’s Overall Findings or Conclusions* (Ref: Para. 45(k))

A144. The form and content of the deliverables from the component auditor are influenced by the nature and extent of the audit work the component auditor has been requested to perform. The group auditor’s firm policies or procedures may address the form or specific wording of an overall conclusion from the component auditor on the audit work performed for purposes of the group audit. In some cases, local law or regulation may specify the form of conclusion (e.g., an opinion) to be provided by the component auditor.

*Evaluating Whether Communications with the Component Auditor Are Adequate for the Group Auditor’s Purposes* (Ref: Para. 46(b))

A144A. If the group auditor determines that the component auditor’s communications are not adequate for the group auditor’s purposes, the group auditor may consider whether, for example:

- Further information can be obtained from the component auditor (e.g., through further discussions or meetings);
- It is necessary to review additional component auditor audit documentation in accordance with paragraph 47;
- Additional audit procedures may need to be performed in accordance with paragraph 48;
- There are any concerns about the component auditor’s competence or capabilities.

*Reviewing Additional Component Auditor Audit Documentation* (Ref: Para. 47)

A145. Paragraph A72 provides guidance for the group auditor in tailoring the nature, timing and extent of the direction and supervision of the component auditor, and the review of their work, based on the facts and circumstances of the group audit and other matters (e.g., the assessed risks of material misstatement of the group financial statements). The group auditor's consideration in accordance with paragraph 47(c) also may be affected by the following matters relevant to the group auditor's ongoing involvement in the work of the component auditor:

- Communications from the component auditor, including those in accordance with paragraph 45 of this proposed SAS~~ISA~~; and
- The review of component auditor audit documentation by the group auditor during the course of the group audit (e.g., to fulfill the requirements of paragraphs 34, 42 and 43) or by the group engagement partner in accordance with paragraph 31 of proposed QM SAS ~~ISA-220 (Revised)~~.

A146. Other factors that may affect the group auditor's determination about whether, and the extent to which, it is necessary to review additional component auditor audit documentation in the circumstances include:

- The degree to which the component auditor was involved in risk assessment procedures and in the identification and assessment of the risks of material misstatement of the group financial statements;
- The significant judgments made by, and the findings or conclusions of, the component auditor about matters that are material to the group financial statements;
- The competence and capabilities of more experienced engagement team members from the component auditor responsible for reviewing the work of less experienced individuals; and
- Whether the component auditor and group auditor are subject to common policies or procedures for review of audit documentation.

**Subsequent Events** (Ref: Para. 49–50)

A147. ~~When the group auditor is assuming responsibility for the work of a component auditors are involved, the~~ group auditor may:

- Request a component auditor to perform subsequent events procedures to assist the group auditor to identify events that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements.
- Perform procedures to cover the period between the date of communication of subsequent events by the component auditor and the date of the auditor's report on the group financial statements.

**Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements**

Understanding the Referred-to Auditor

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors (Ref:

Para. 50.1)

A147.2 When the group engagement partner determines to make reference, the referred-to auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit. Such requirements may be different or in addition to those applying to a referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory or other reasons in the referred-to auditor's jurisdiction. When the referred-to auditor is not subject to the AICPA Code of Professional Conduct, compliance by the referred-to 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 referred-to auditor's ethical responsibilities in the group audit.

Competence and Capabilities of Referred-To Auditors (Ref: Para. 50.2-50.3)

A147.3 Determining whether referred-to auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement.

A147.3.1 In determining whether referred-to auditors have the appropriate competence and capabilities, the group engagement partner may consider matters such as:

- Previous experience with or knowledge of the referred-to auditor.
- The referred-to auditor's specialized skills (e.g., industry specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies).
- The referred-to auditor's understanding of the auditing and other standards applicable to the group audit, such as GAAS that is sufficient to fulfill the referred-to auditor's responsibilities.
- Whether a referred-to auditor operates in a regulatory environment that actively oversees auditors.

A147.3.2 The procedures to determine the referred-to auditor's competency and capability may include, for example:

- Requesting the referred-to auditor to confirm the matters referred to in paragraph 50.2 in writing.
- Obtaining published external inspection reports, peer review reports on the component auditor's firm and other relevant publicly available information relating to the professional reputation and standing of a referred-to auditor.

Determining Whether to Make Reference (Ref: Para. 50.4-50.5)

A147.4 In accordance with this proposed SAS, the group engagement partner determines, individually for each component, whether to

- a. be involved in the work of the component auditor, insofar as that work relates to the expression of an audit opinion on the group financial statements, or
- b. make reference to, the audit of a referred-to auditor in the auditor's report on the group financial statements.

A147.4.1 In group audits involving two or more potential referred-to auditors, the decision to make reference is made individually for each potential referred-to auditor. The group auditor may make reference to any, all, or none of the potential referred-to auditors. For example, if components are audited by an auditor from a network firm and one component is audited by another firm, the group engagement partner may decide to be involved in the work of the auditor from the network firm and

to make reference to the work of the auditor from the other firm.

A147.4.2 Factors that may affect the group engagement partner's determination of whether to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the following:

- The group auditor's understanding of the group and its environment and the group's system of internal control
- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable
- Differences in the auditing and other standards applied by the auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group auditor to be involved in the work of an auditor.

*Determining Whether the Audit Was Conducted in Accordance With GAAS (Ref: Para. 50.5(a))*

A147.5 An auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph 50.5(a). When the auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph 50.5(a), relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group auditor may provide the referred-to auditor with AU-C Appendix B, *Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards*, that identifies substantive requirements of GAAS that are not requirements in the ISAs. The referred-to auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the referred-to auditor required by paragraph 50.9-50.10 may address whether the audit met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the referred-to auditor, may decide to make reference to the audit of that referred-to auditor in the auditor's report on the group financial statements.

*Determining Whether to Make Reference When the Financial Reporting Framework is Not the Same (Ref: Para. 50.5.1)*

A147.6. When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group auditor is required by this proposed SAS to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the

group auditor –is involved in the work of the auditor. In rare circumstances, however, the group engagement partner may conclude that the group auditor can reasonably expect to obtain 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 be involved in the work of the auditor.

A147.7. The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of all material items in the component’s financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and *International Financial Reporting Standard for Small and Medium-sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP.

A147.8. Additional considerations in determining whether it may be appropriate to make reference to the audit of a potential referred-to auditor in the auditor’s report on the group financial statements when the component prepares financial statements using a different financial reporting framework than that used by the group include the

- effectiveness of groupwide controls and the adequacy of the consolidation process specifically related to the adjustments to convert the component’s financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments.
- depth of the group auditor’s understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments.
- extent of the group auditor’s knowledge of the financial reporting framework used to prepare the component financial statements.
- group auditor’s ability to obtain information from group or component management that is relevant to the adjustments.
- need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments.

*Considerations for Governmental Entities*

A147.9. When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting

framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by the Governmental Accounting Standards Board and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs 50.5.1 and 50.6c are not relevant.

*Making Reference* (Ref: Par. 50.6-50.7)

A147.10 Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor is not to be construed as a qualification of the opinion, but rather is intended to communicate (1) that the group auditor was not involved in the work of the referred-to auditor, and (2) the source of the audit evidence with respect to those components for which reference to the audit of referred-to auditors is made.

A147.11 The disclosure of the magnitude of the portion of the financial statements audited by a referred-to auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a referred-to auditor. When two or more referred-to auditors are referred to, the dollar amounts or the percentages covered by the referred-to auditors may be stated in the aggregate.

A147.12 Exhibit A contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a referred-to auditor.

*Modified Opinion in Referred to Auditor's Report* (Ref: par. 50.8)

A147.13 If the modified opinion, emphasis-of-matter paragraph, -other-matter paragraph, or going concern section in the referred-to auditor's report does not affect the report on the group financial statements and the referred-to auditor's report is not presented, the group auditor need not make reference to those paragraphs or section in the auditor's report on the group financial statements. If the referred-to auditor's report is presented, the group auditor may make reference to those paragraphs or section and their disposition.

*Subsequent Events* (Ref: Para. 50.13)

A147.14. When the group engagement partner determines to make reference, procedures designed to identify subsequent events between the date of the referred-to auditor's report and the date of the auditor's report on the group financial statements may include:

- (a) Obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified.
- (b) Requesting the referred-to auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements.
- (c) Requesting written representation from component management regarding subsequent events.
- (d) Reading available interim financial information of the component and making inquiries of group management.
- (e) Reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date.

- (f) Reading the subsequent year's capital and operating budgets.
- (g) Inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events.
- (h) Considering the implications for the auditor's report on the group financial statements if the group auditor has been unable to obtain sufficient appropriate audit evidence regarding subsequent events.

## Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

### *Sufficiency and Appropriateness of Audit Evidence* (Ref: Para. 51)

A148. The audit of group financial statements is a cumulative and iterative process. As the group auditor performs planned audit procedures, the audit evidence obtained may cause the group auditor to modify the nature, timing, or extent of other planned audit procedures as information may come to the group auditor's attention that differs significantly from the information on which the risk assessment was based. For example:

- The misstatements identified at a component may need to be considered in relation to other components; or
- The group auditor may become aware of access restrictions to information or people at a component because of changes in the environment (e.g., war, civil unrest, or outbreaks of disease).

In such circumstances, the group auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the significant classes of transactions, account balances, or disclosures and related assertions.

A149. The evaluation required by paragraph 51 assists the group auditor in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in AU-C section ISA 330<sup>90</sup> for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material class of transactions, account balance, and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.

A150. The group auditor may consider the engagement team's exercise of professional skepticism when evaluating the sufficiency and appropriateness of audit evidence obtained. For example, the group auditor may consider whether matters such as those described in paragraph A16 have inappropriately led the engagement team to:

- Obtain audit evidence that is easier to access without giving appropriate consideration to its relevance and reliability;
- Obtain less persuasive evidence than is necessary in the circumstances; or
- Design and perform audit procedures in a manner that is biased towards obtaining evidence that is corroborative or excluding evidence that is contradictory.

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<sup>90</sup> Paragraph 18 Of AU-C section ISA 330, paragraph 18

A151. Proposed QM SAS ISA 220 (Revised)<sup>91</sup> requires the engagement partner to determine, on or before the date of the auditor's report, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. Information that may be relevant to the group auditor's evaluation of the audit evidence obtained from the work performed by component auditors or referred-to auditors depends on the facts and circumstances of the group audit, and may include:

- The communications from the component auditors required by paragraph 45, including the overall findings or conclusions of the component auditors on the work performed for purposes of the group audit;
- Other communications from the component auditors throughout the group audit, including those required by paragraph 32; and
- The group auditor's direction and supervision of the component auditors, and review of their work, including, as applicable, the group auditor's review of additional component auditor audit documentation in accordance with paragraph 47.
- The referred-to auditor's report on the component's financial statements, including, as applicable, if the opinion of a referred-to auditor is modified or if that report includes an emphasis-of-matter paragraph, an ~~or~~ other-matter paragraph, or a going concern section.
- The communications from the referred-to auditors required by this proposed- SAS.

A152. In some circumstances, an overall summary memorandum describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.

*Evaluating the Effect on the Group Audit Opinion (Ref: Para: 52)*

A153. The group engagement partner's evaluation may include a consideration of whether corrected and uncorrected misstatements communicated by component auditors indicate a systemic issue (e.g., regarding transactions subject to common accounting policies or common controls) that may affect other components.

**Auditor's Report (Ref: Para: 53)**

~~A154. Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings or conclusions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.~~

~~A155. When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Qualified Opinion or Basis for Disclaimer of Opinion section in the auditor's report on the~~

<sup>91</sup> Paragraph 32 of proposed QM SAS ISA 220 (Revised), paragraph 32

~~group financial statements describes the reasons for that inability.<sup>92</sup> In some circumstances, a reference to a component auditor may be necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.~~

## Communication with Group Management and Those Charged with Governance of the Group

### *Communication with Group Management* (Ref: Para. 54–56)

A156. The group audit may be complex due to the number and nature of the entities and business units comprising the group. In addition, as explained in paragraph A7, the group auditor may determine that certain entities or business units may be considered together as a component for purposes of planning and performing the group audit. Therefore, discussing with group management an overview of the planned scope and timing may help in coordinating the work performed at components, including when component auditors are involved or reference is made to referred-to auditors, and in identifying component management (see paragraph A22).

A157. AU-C section ISA 240<sup>93</sup> contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.

A158. Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation.
- Plans for abandonment of material operating assets.
- Subsequent events.
- Significant legal agreements.

A159. Group management may inform the group auditor about non-compliance or suspected non-compliance with laws or regulations in entities or business units within the group. Paragraph A84 provides guidance for the group engagement partner in these circumstances.

### *Communication with Those Charged with Governance of the Group* (Ref: Para. 57)

A160. The matters the group auditor communicates to those charged with governance of the group may include those brought to the attention of the group auditor by component auditors or referred-to auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group may take place at various times during the group audit. For example, the matter referred to in paragraph 57(a) may be communicated after the group auditor has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph 57(b) may be communicated at the end of the audit, and the matters referred to in paragraph 57(c)–(d) may

<sup>92</sup> ~~Paragraphs 21 and 25 of AU-C section ISA 705, *Modifications to the Opinion in the Independent Auditor's Report*, of SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements* (Revised), paragraphs 20 and 24~~

<sup>93</sup> ~~Paragraphs 40-42 of AU-C section ISA 240, paragraphs 41–43~~

be communicated when they occur.

A161. ~~AU-C section ISA 260 (Revised)~~<sup>94</sup> requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. For a group audit, this communication helps those charged with governance understand the group auditor's determination of the components at which audit work will be performed, including whether certain of the group's entities or business units will be considered together as a component, and the planned involvement of component auditors. This communication also helps to enable a mutual understanding of and discussion about the group and its environment (see paragraph 30) and areas, if any, in which those charged with governance may request the group auditor to undertake additional procedures.

*Communication of Identified Deficiencies in Internal Control* (Ref: Para. 58)

A162. The group auditor is responsible for determining, on the basis of the audit work performed, whether one or more identified deficiencies, individually or in combination, constitute significant deficiencies ~~or material weaknesses~~.<sup>95</sup> The group auditor may request input from the component auditor about whether an identified deficiency or combination of deficiencies at the component is a significant deficiency ~~or material weakness~~ in internal control.

**Documentation** (Ref: Para. 59)

A163. Other ~~AU-C sections ISAs~~ contain specific documentation requirements that are intended to clarify the application of ~~AU-C section ISA 230~~ in the particular circumstances of those other ~~AU-C sections ISAs~~. The Appendix to ~~AU-C section ISA 230~~ lists other ~~AU-C sections ISAs~~ that contain specific documentation requirements and guidance.

A164. The audit documentation for the group audit supports the group auditor's evaluation in accordance with paragraph 51 as to whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion. Also see paragraph A151.

A165. The audit documentation for the group audit comprises:

- The documentation in the group auditor's file; and
- The separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit (i.e., component auditor audit documentation).

A166. The final assembly and retention of the audit documentation for a group audit is subject to the policies or procedures of the group auditor's firm in accordance with ~~proposed ISQMS 1~~.<sup>96</sup> The group auditor may provide specific instructions to component auditors regarding the assembly and retention of the documentation of work performed by them for purposes of the group audit.

*Basis for the Group Auditor's Determination of Components* (Ref: Para: 59(b))

A167. The basis for the group auditor's determination of components ~~and the basis for the decision to make reference to the audit of a referred-to auditor~~ may be documented in various ways, including, for example, documentation related to the fulfillment of the requirements in paragraphs 22, 33 and 57(a) of this ~~proposed SAS ISA~~.

<sup>94</sup> ~~Paragraph 11 of AU-C section ISA 260 (Revised), paragraph 15~~

<sup>95</sup> ~~Paragraph 9 of AU-C section ISA 265, paragraph 8~~

<sup>96</sup> ~~Paragraphs 32(f) and A87-A89 of proposed ISQMS 1, paragraphs 31(f) and A83-A85~~

*Basis for the Group Auditor's Determination of the Competence and Capabilities of Component Auditors*  
(Ref: Para: 59(d))

A168. ~~Proposed ISQMS~~ 1<sup>97</sup> provides guidance on matters that the firm's policies or procedures may address regarding the competence and capabilities of the engagement team members. Such policies or procedures may describe or provide guidance about how to document the determination of the competence and capabilities of the engagement team, including component auditors. For example, the confirmation obtained from the component auditor in accordance with paragraph 24 may include information about the component auditor's relevant industry experience. The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures (see paragraph A59).

*Documentation of the Direction and Supervision of Component Auditors and the Review of Their Work* (Ref: Para. 59(f))

A169. As described in paragraph A72, the approach to direction, supervision and review in a group audit will be tailored by the group auditor based on the facts and circumstances of the engagement, and will generally include a combination of addressing the group auditor's firm policies or procedures and responses specific to the group audit. Such policies or procedures may also describe or provide guidance about the documentation of the group auditor's direction and supervision of the engagement team and the review of their work.

A170. ~~AU-C section ISA~~ 300<sup>98</sup> requires the auditor to develop an audit plan that includes a description of the nature, timing and extent of the planned direction and supervision of engagement team members and the review of their work. When component auditors are involved, the extent of such descriptions will often vary by component, recognizing that the planned nature, timing and extent of direction and supervision of component auditors, and review of their work, may be influenced by the matters described in paragraph A48.

A171. The group auditor's documentation of the direction and supervision of component auditors and the review of their work may include, for example:

- Required communications with component auditors, including any instructions issued and other confirmations required by this ~~proposed SAS~~ISA.
- The rationale for the selection of visits to component auditor sites, attendees at meetings and the nature of the matters discussed.
- Matters discussed in meetings with component auditors or component management.
- The rationale for the group auditor's determination of component auditor audit documentation selected for review.
- Changes in the planned nature and extent of involvement with component auditors, and the reasons why. This may include circumstances in which the group auditor modified the nature, timing or extent of the direction and supervision of the component auditors, and the review of their work, in areas of the audit that are more complex or subjective than initially anticipated.

A172. Paragraph 47 requires the group auditor to determine whether, and the extent to which it is necessary

<sup>97</sup> ~~Paragraph A100 of proposed ISQMS 1, paragraph A96~~

<sup>98</sup> ~~Paragraph 9 of AU-C section ISA 300, paragraph 9~~

to review additional component auditor audit documentation. Paragraphs A145–A146 provide guidance for the group auditor in making this determination.

A173. Component auditor audit documentation ordinarily need not be replicated in the group auditor’s audit file. However, the group auditor may decide to summarize, replicate or retain copies of certain component auditor documentation in the group auditor’s audit file to supplement the description of a particular matter in communications from the component auditor, including the matters required to be communicated by this proposed SAS. Examples of such component auditor documentation may include:

- A listing or summary of the significant judgments made by the component auditor, and the conclusions reached thereon, that are relevant to the group audit;
- Matters that may need to be communicated to those charged with governance of the group; or
- Matters that may be determined to be key audit matters to be communicated in the auditor’s report on the group financial statements.

A174. When required by law or regulation, certain component auditor documentation may need to be included in the group auditor’s audit file, for example, to respond to the request of a regulatory authority to review documentation related to work performed by a component auditor.

A175. Policies or procedures established by the firm in accordance with the firm’s system of quality management, or resources provided by the firm or a network, may assist the group auditor in documenting the direction and supervision of component auditors and the review of their work. For example, an electronic audit tool may be used to facilitate communications between the group auditor and component auditors. The electronic audit tool also may be used for audit documentation, including providing information about the reviewer(s) and the date(s) and extent of their review.

*Additional Considerations When Access to Component Auditor Audit Documentation is Restricted* (Ref: Para. 59)

A176. Audit documentation for a group audit may present some additional complexities or challenges in certain circumstances. This may be the case, for example, when law or regulation restrict the component auditor from providing documentation outside of its jurisdiction, or when war, civil unrest or outbreaks of disease restrict access to relevant component auditor audit documentation.

A177. The group auditor may be able to overcome such restrictions by, for example:

- Visiting the location of the component auditor, or meeting with the component auditor in a location different from where the component auditor is located, to review the component auditor’s audit documentation;
- Reviewing the relevant audit documentation remotely through the use of technology, when not prohibited by law or regulation;
- Requesting the component auditor to prepare and provide a memorandum that addresses the relevant information and holding discussions with the component auditor, if necessary, to discuss the contents of the memorandum; or
- Discussing with the component auditor the procedures performed, the evidence obtained and the conclusions reached by the component auditor.

It is a matter of professional judgment whether one or more of the actions described above may be sufficient to overcome the restrictions depending on the facts and circumstances of the group audit.

A178. When access to component auditor audit documentation is restricted, the group auditor's documentation nonetheless needs to comply with the requirements of ~~GAAS~~the ISAs, including those relating to the documentation of the nature, timing and extent of the group auditor's direction and supervision of component auditors and the review of their work. The guidance in paragraphs A145–A146 may be helpful in determining the extent of the group auditor's review of the component auditor audit documentation in these circumstances. Paragraphs A173 and A174 provide examples of circumstances in which certain component auditor audit documentation may be included in the group auditor's audit file.

A179. If the group auditor is unable to overcome restrictions on access to the component auditor audit documentation, the group auditor may need to consider whether a scope limitation exists that may require a modification to the opinion on the group financial statements. See paragraph A42.

## Appendix 1: Illustrative Auditor's Reports on Group Financial Statements

(Ref: Para. A42)

### Illustration ~~1~~<sup>of</sup> Independent Auditor's Report With a Qualified Opinion When the Group Auditor Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Auditor's Opinion

~~For purposes of this illustrative auditor's report, the following circumstances include the following are assumed:~~

- ~~• Audit of a complete set of consolidated general purpose financial statements of an entity other than a listed entity using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA 600 (Revised) applies).~~
- ~~• The consolidated financial statements are prepared by Mmanagement is responsible for the preparation of the consolidated financial statements of the entity in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board (FRSs) (a general purpose framework).~~
- The terms of the audit engagement reflect the description of management's responsibility for the consolidated financial statements in AU-C section ISA 210, Terms of Engagement.
- The group auditor is unable to obtain sufficient appropriate audit evidence relating to a component accounted for by the equity method because the group auditor was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a referred-to auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor's report contains a qualified opinion (recognized at \$15 million in the statement of financial position, which reflects total assets of \$60 million) because the group auditor did not have access to the accounting records, management, or auditor of the component.
- ~~• The group auditor has read the audited financial statements of the component as at December 31, 20X1, including the auditor's report thereon, and considered related financial information kept by group management in relation to the component.~~
- ~~• In the group engagement partner's judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive.<sup>4</sup>~~
- ~~• The IESBA Code comprises all of the relevant ethical requirements that apply to the audit.~~
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events considered in the aggregate that raise a material uncertainty does not exist related to events or conditions that may cast substantial significant doubt about on the entity's ability to continue as a going concern in accordance with ISA 570 (Revised).
- The auditor ~~is not required, and has not been engaged otherwise not decided,~~ to communicate

<sup>4</sup>—If, in the group engagement partner's judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with AU-C section ISA 705 (Revised).

key audit matters in accordance with AU-C section ISA 701.<sup>2</sup>

- The auditor has obtained all ~~of~~ the other information prior to the date of the auditor's report and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.
- ~~Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.~~
- ~~In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law.~~

### ~~INDEPENDENT AUDITOR'S REPORT~~Independent Auditor's Report

~~To the Shareholders of ABC Company [or Other Appropriate Addressee]~~

#### **Report on the Audit of the Consolidated Financial Statements<sup>3</sup>**

##### **Qualified Opinion**

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as ~~of~~ December 31, 20X1, and the related consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements, ~~including a summary of significant accounting policies.~~

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects ~~(or give a true and fair view of)~~, the consolidated financial position of the Group as ~~of~~ December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America International Financial Reporting Standards (IFRSs).

##### **Basis for Qualified Opinion**

~~We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$ \_\_\_\_\_ and \$ \_\_\_\_\_ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$ \_\_\_\_\_ and \$ \_\_\_\_\_, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures. ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at \$15 million on the consolidated statement of financial position as at December 31, 20X1, and ABC's share of XYZ's net income of \$1 million is included in the consolidated statement of comprehensive income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.~~

We conducted our audit in accordance with auditing standards generally accepted in the United States

<sup>2</sup> AU-C section ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

<sup>3</sup> The sub-title, "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title, "Report on Other Legal and Regulatory Requirements" is not applicable.

~~of America (GAAS) International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are required to be independent of ABC Company and its subsidiaries and to meet the Group in accordance with the International Ethics Standards Board for Accountants’ International Code of Ethics for Professional Accountants (including International Independence Standards) (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.~~

~~**Other Information [or another title if appropriate such as “Information Other than the Financial Statements and Auditor’s Report Thereon”]**~~

~~[Reporting in accordance with the reporting requirements in ISA 720 (Revised)<sup>4</sup>— see Illustration 6 in Appendix 2 of ISA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]~~

~~**Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements<sup>5</sup>**~~

~~Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.~~

~~In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company’s ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].~~

~~[Reporting in accordance with ISA 700 (Revised)<sup>6</sup>— see Illustration 2 in ISA 700 (Revised).]~~

~~**Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements**~~

~~Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.~~

~~[Reporting in accordance with ISA 700 (Revised)— see Illustration 2 in ISA 700 (Revised). The last two paragraphs which are applicable for audits of listed entities only would not be included.]~~

~~In performing an audit in accordance with GAAS, we:~~

<sup>4</sup>—AU-C section ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*

<sup>5</sup>—Throughout these illustrative auditor’s reports, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>6</sup>—AU-C section ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>7</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information [for another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

### **Report on Other Legal and Regulatory Requirements**

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Reporting in accordance with ISA 700 (Revised) — see Illustration 2 in ISA 700 (Revised).]

[Signature of auditor's firm in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]

[City and state where the auditor's report is issued Auditor-Address]

[Date of the auditor's report]

If, in the group engagement partner's judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with ISA 705 (Revised).

### **Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards**

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).

- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor of the group financial statements is making referenceto the audit of the financial statements of a component preparedusing the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concludedthat there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

### **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Consolidated Financial Statements<sup>8</sup>**

#### **Opinion**

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

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<sup>8</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable

**Basis for Opinion**

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Responsibilities of Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

**Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>9</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate,

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<sup>9</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable

that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

Other Information [for another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]  
[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

### **Report on Other Legal and Regulatory Requirements**

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

### **Illustration 3— A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS**

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.

### **Independent Auditor's Report**

[Appropriate Addressee]

### **Report on the Consolidated Financial Statements<sup>1</sup>**

#### **Opinion**

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and

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<sup>1</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

### **Basis for Opinion**

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Responsibilities of Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

#### **Report on Other Legal and Regulatory Requirements**

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

#### **Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS**

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

#### **Independent Auditor's Report**

[Appropriate Addressee]

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<sup>2</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable

**Report on the Consolidated Financial Statements<sup>1</sup>****Opinion**

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.

**Basis for Opinion**

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Responsibilities of Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

**Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

<sup>1</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

**Report on Other Legal and Regulatory Requirements**

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

## Appendix 2

(Ref: Para. A85)

### Understanding the Group’s System of Internal Control

1. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how ~~AU-C section 315~~~~SA 315 (Revised 2019)~~<sup>1</sup> is to be applied in relation to an audit of group financial statements. The examples may not be relevant to every group audit engagement and the list of examples is not necessarily complete.

#### Control Environment

2. The group auditor’s understanding of the control environment may include matters such as the following:
  - The structure of the governance and management functions across the group, and group management’s oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group.
  - How oversight over the group’s system of internal control by those charged with governance is structured and organized.
  - How ethical and behavioral standards are communicated and reinforced in practice across the group, (e.g., group-wide programs, such as codes of conduct and fraud prevention programs).
  - The consistency of policies and procedures across the group, including a group financial reporting procedures manual.

#### The Group’s Risk Assessment Process

3. The group auditor’s understanding of the group’s risk assessment process may include matters such as group management’s risk assessment process, that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group’s risk assessment process is and the involvement of entities and business units in this process.

#### The Group’s Process to Monitor the System of Internal Control

4. The group auditor’s understanding of the group’s process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, when relevant, activities of the internal audit function across the group. The group’s internal audit function, including its nature, responsibilities, and activities in respect of monitoring of controls at entities or business units in the group. ISA 610 (Revised 2013)<sup>2</sup> requires the auditor to evaluate the extent to which the internal audit function’s organizational status and relevant policies and procedures support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a

<sup>1</sup> ~~Appendix C of SAS No. 145~~~~AU-C section 315~~~~SA 315 (Revised 2019)~~, ~~Appendix 3~~

<sup>2</sup> ~~AU-C section~~~~ISA 610 (Revised 2013)~~, *Using the Work of Internal Auditors*, paragraph 15

systematic and disciplined approach, including quality control.

### **The Information System and Communication**

5. The group auditor's understanding of the group's information system and communication may include matters such as the following:
  - The extent of centralization in the group's IT environment and the commonality of IT applications, IT processes and IT infrastructure.
  - Group management's monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to monitor performance against budgets, and to take appropriate action.
  - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at group level.
  - A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group.

### *Consolidation Process*

6. The group auditor's understanding of the consolidation process may include matters such as the following:
  - Matters relating to the applicable financial reporting framework:
  - The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework.
  - The process for identifying and accounting for entities or business units in the group in accordance with the applicable financial reporting framework.
  - The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework.
  - The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework.
  - The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework.
  - The procedures for dealing with entities or business units in the group with financial year-ends different from the group's year-end.

Matters relating to the consolidation process:

- Group management's process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial statements, and that differences in accounting policies are identified, and adjusted when required in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the entities or business units in the group use to report similar

transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.

- Group management's process for ensuring complete, accurate and timely financial reporting by the entities or business units in the group for the consolidation.
- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial statements.
- How the group's IT environment is organized for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters relating to consolidation adjustments and reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorization and processing of related journal entries, and the experience of personnel responsible for the consolidation.
- The consolidation adjustments required by the applicable financial reporting framework.
- The business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature, and size of transactions between entities or business units in the group.
- The procedures for monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework.
- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (e.g., an obligation of the minority interest to make good such losses).

### **Control Activities**

7. The group auditor's understanding of the control activities component may include matters such as the following:
  - The commonality of information processing controls and general IT controls for all or part of the group.
  - The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial statements at the assertion level.
  - The extent to which commonly designed controls have been implemented consistently for all or part of the group.

## Appendix 3

(Ref: Para. A110)

### Examples of Events or Conditions that May Give Rise to Risks of Material Misstatement of the Group Financial Statements

The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degree. Also see ISA 315 (Revised 2019), Appendix 2.

Inherent Risk Factor	Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Statements at the Assertion Level:
Complexity	<ul style="list-style-type: none"> <li>• The existence of complex transactions that are accounted for in more than one entity or business units in the group.</li> <li>• The application of accounting policies by entities or business units in the group that differ from those applied to the group financial statements.</li> <li>• Accounting measurements or disclosures that involve complex processes used by entities or business units in the group such as accounting for complex financial instruments.</li> <li>• Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation.</li> </ul>
Subjectivity	<ul style="list-style-type: none"> <li>• Judgments regarding which entities or business units in the group require incorporation of their financial information in the group financial statements in accordance with the applicable financial reporting framework, for example, whether any special-purpose entities or non-trading entities exist and require incorporation.</li> <li>• Judgments regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group.</li> </ul>
Change	<ul style="list-style-type: none"> <li>• Frequent acquisitions, disposals, or reorganizations.</li> </ul>
Uncertainty	<ul style="list-style-type: none"> <li>• Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade and fiscal policy, and restrictions on currency and dividend movements; and fluctuations in exchange rates.</li> </ul>

Susceptibility to Misstatement Due to Management Bias or Other Fraud Risk Factors Insofar as They Affect Inherent Risk	<ul style="list-style-type: none"> <li>• Unusual related party relationships and transactions.</li> <li>• Entities or business units in the group with different financial year-ends, which may be utilized to manipulate the timing of transactions.</li> <li>• Prior occurrences of unauthorized or incomplete consolidation adjustments.</li> <li>• Aggressive tax planning within the group, or large cash transactions with entities in tax havens.</li> <li>• Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.</li> <li>• Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk</li> </ul>
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Indicators that the control environment, the group’s risk assessment process or the group’s process to monitor the group’s system of internal control are not appropriate to the group’s circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group’s system of internal control, include:

- Poor corporate governance structures, including decision making processes that are not transparent.
- Non-existent or ineffective controls over the group’s financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group.

**Proposed Statement on Auditing Standards, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***  
(Clean Draft)

## Introduction

### Scope of this Proposed SAS

1. Generally accepted auditing standards (GAAS) apply to an audit of group financial statements (a group audit). This proposed Statement on Auditing Standards (SAS) addresses special considerations that apply to a group audit, including in those circumstances when component auditors are involved or when the group auditor makes reference to the audit of a referred-to auditor. The requirements and guidance in this proposed SAS refer to, or expand on, the application of other relevant AU-C sections to a group audit, in particular proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS),<sup>1</sup> AU-C section 230, *Audit Documentation*,<sup>2</sup> AU-C section 300, *Planning an Audit*,<sup>3</sup> AU-C section 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*,<sup>4</sup> and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.<sup>5</sup> (Ref: Para. A1–A2)
2. Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph 14(k). The term consolidation process as used in this proposed SAS refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions. (Ref: Para. A3–A5, A25)
- 2.1. Government entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide, *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.
3. As explained in proposed QM SAS,<sup>6</sup> this proposed SAS, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this proposed SAS may be useful when involving such an individual to attend a physical inventory count, inspect property, plant, and equipment, or perform audit procedures at a shared service center at a remote location.

### Groups and Components

4. A group may be organized in various ways. For example, a group may be organized by legal or other

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<sup>1</sup> Proposed QM SAS, *Quality Management for an Engagement Performed in Accordance with Generally Accepted Auditing Standards*

<sup>2</sup> AU-C section 230, *Audit Documentation*

<sup>3</sup> AU-C section 300, *Planning an Audit*

<sup>4</sup> AU-C section 315, *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment*

<sup>5</sup> AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

<sup>6</sup> Paragraph A1 of proposed QM SAS

entities (e.g., a parent and one or more subsidiaries, joint ventures, or investments accounted for by the equity method). Alternatively, the group may be organized by geography, by other economic units (including branches or divisions), or by functions or business activities. In this proposed SAS, these different forms of organization are collectively referred to as “entities or business units.” (Ref: Para. A6)

5. The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, the group auditor uses professional judgment in determining the components at which audit work will be performed. This determination is based on the group auditor’s understanding of the group and its environment, and other factors such as the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and internal control. (Ref: Para. A7–A9)

*Involvement of Component Auditors*

6. Proposed QM SAS <sup>7</sup> requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. In a group audit, such resources may include component auditors. Therefore, this proposed SAS requires the group auditor to determine the nature, timing, and extent of involvement of component auditors.
7. The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this proposed SAS. Component auditors may have greater experience with, and a more in-depth knowledge of, the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit. (Ref: Para. A10–A10A)
8. Audit risk is a function of the risks of material misstatement and detection risk.<sup>8</sup> Detection risk in a group audit includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this proposed SAS requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this proposed SAS explains the matters that the group auditor takes into account when determining the nature, timing and extent of the direction and supervision of component auditors and the review of their work. (Ref: Para. A11–A12)

*Making Reference to the Audit of a Referred-To Auditor*

- 8.1 This proposed SAS also describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements. Reference in the auditor’s report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor communicates the source of audit evidence with respect to those components for which such reference is made. When component auditors are involved, no reference is made to the

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<sup>7</sup> Paragraph 25 of proposed QM SAS

<sup>8</sup> Paragraph A38 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

component auditor in the auditor’s report on the group financial statements.

*Professional Skepticism*

9. In accordance with AU-C section 200,<sup>9</sup> the engagement team is required to plan and perform the group audit with professional skepticism and to exercise professional judgment. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement team, including emphasizing the importance of each engagement team member exercising professional skepticism throughout the group audit. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate exercise of professional skepticism. (Ref: Para. A13–A17)

*Scalability*

10. This proposed SAS is intended for all group audits, regardless of size or complexity. However, the requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each group audit. For example, when a group audit is carried out entirely by the group auditor, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of component auditors. This may be the case when the group auditor is able to perform audit procedures centrally or is able to perform procedures at the components without involving component auditors. The guidance in paragraphs A117 and A118 also may be helpful in applying this proposed SAS in these circumstances.

*Responsibilities of the Group Engagement Partner and Group Auditor*

11. The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this proposed SAS. 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. (Ref: Para. A17.1-A17.3, A27)

**Effective Date**

12. This proposed SAS is effective for audits of group financial statements for periods beginning on or after December 15, 2025.

**Objectives**

13. The objectives of the auditor are to:

- (a) With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements;
- (a.1) Determine whether to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements, and if so, report in accordance with this proposed SAS;
- (b) Identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately

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<sup>9</sup> Paragraphs 17-18 and A24-A28 of AU-C section 200

respond to those assessed risks;

- (c) Be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and evaluating the results of that work; and
- (d) Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, as a basis for forming an opinion on the group financial statements.

## Definitions

14. For purposes of GAAS, the following terms have the meanings attributed as follows:

- (a) Aggregation risk – The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. (Ref: Para. A18)
- (b) Component – An entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit. (Ref: Para. A19-A19.1)
- (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 team<sup>10</sup> for a group audit. (Ref: Para. A20–A21A)
- (d) Component management – Management responsible for a component. (Ref: Para. A22)
- (e) Component performance materiality – An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.
- (f) Group – A reporting entity for which group financial statements are prepared.
- (g) Group audit – The audit of group financial statements.
- (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.
- (i) Group audit opinion – The audit opinion on the group financial statements.
- (j) Group engagement partner – The engagement partner<sup>11</sup> who is responsible for the group audit. (Ref: Para. A23)
- (k) Group financial statements – Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this proposed SAS, a consolidation process includes the following: (Ref: Para. A24–A26)

<sup>10</sup> Paragraph 12 of proposed QM SAS

<sup>11</sup> Paragraph 12 of proposed QM SAS

- (i) Consolidation, proportionate consolidation, inclusion, or an equity method of accounting;
  - (ii) The presentation in combined financial statements of the financial information of entities or business units that are under common control or common management; or
  - (iii) The aggregation of the financial information of entities or business units such as branches or divisions.
- (l) Group management – Management responsible for the preparation of the group financial statements.
  - (m) Group performance materiality – Performance materiality<sup>12</sup> in relation to the group financial statements as a whole, as determined by the group auditor.
  - (m.1) 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. (Ref: Para. A26.1)
15. Reference in this proposed SAS to “the applicable financial reporting framework” means the financial reporting framework that applies to the group financial statements. (Ref: Para. A26.2)

## Requirements

### Leadership Responsibilities for Managing and Achieving Quality on a Group Audit

16. In applying proposed QM SAS,<sup>13</sup> the group engagement partner is required to take overall responsibility for managing and achieving quality on the group audit engagement. In doing so, the group engagement partner should: (Ref: Para. A27–A28)
- (a) Take responsibility for creating an environment for the group audit engagement that emphasizes the expected behavior of engagement team members. (Ref: Para. A29)
  - (b) Be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement.

### Acceptance and Continuance

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. (Ref: Para. A30–A33.2)
- 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 (Ref: Para. A33.1-A33.2)
18. If, after the acceptance or continuance of the group audit engagement, the group engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the group engagement partner should consider the possible effects on the group audit. (Ref: Para. A34)

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<sup>12</sup> Paragraphs 9 and 11 of AU-C section 320, *Materiality in Planning and Performing an Audit*

<sup>13</sup> Paragraph 13 of proposed QM SAS

*Terms of the Engagement*

19. In applying AU-C section 210, *Terms of Engagement*<sup>14</sup> the group auditor should obtain the agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with: (Ref: Para. A35)
- (a) Access to all information of which group management is aware that is relevant to the preparation of the group financial statements such as records, documentation, and other matters;
  - (b) Additional information that the engagement team may request from group management or component management for the purpose of the group audit; and
  - (c) Unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence.

*Restrictions on Access to Information or People Outside the Control of Group Management*

20. 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 should consider the possible effects on the group audit. (Ref: Para. A36–A43)

*Restrictions on Access to Information or People Imposed by Group Management*

21. If the group engagement partner concludes that: (Ref: Para. A41–A43)
- (a) It will not be possible for the group auditor 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 should either:
- (i) In the case of an initial engagement, not accept the engagement, or, in the case of a recurring engagement, withdraw from the engagement, when withdrawal is possible under applicable law or regulation; or
  - (ii) When the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements.

**Overall Group Audit Strategy and Group Audit Plan**

22. In applying AU-C section 300,<sup>15</sup> the group auditor should establish, and update as necessary, an overall group audit strategy and group audit plan. In doing so, the group auditor shall determine: (Ref: Para. A44–A47)
- (a) The components at which audit work will be performed; (Ref: Para. A48)
  - (b) The resources needed to perform the group audit engagement, including the nature, timing and extent to which component auditors are to be involved; and (Ref: Para. A49–A53)
- (b.1) The components for which, if any, the auditor's report on the group financial statements will

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<sup>14</sup> Paragraphs 6(b) and 8(b) of AU-C section 210, *Terms of Engagement*

<sup>15</sup> Paragraphs 7-10 of AU-C section 300

make reference to the audit of a referred-to auditor, as discussed in paragraphs 50.1-50.13.

*Considerations When Component Auditors Are Involved*

- 23. In establishing the overall group audit strategy and group audit plan, the group engagement partner should evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor. (Ref: Para. A54)
- 24. As part of the evaluation in paragraph 23, the group auditor should request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. (Ref: Para. A55)

*Relevant Ethical Requirements, Including Those Related to Independence*

- 25. In applying proposed QM SAS,<sup>16</sup> the group engagement partner should take responsibility for: (Ref: Para. A56–A57, A84)
  - (a) Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and
  - (b) Confirming whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.

*Engagement Resources*

- 26. In applying proposed QM SAS,<sup>17</sup> the group engagement partner should: (Ref: Para. A58–A65)
  - (a) Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component; and
  - (b) If information about the results of the monitoring and remediation process or external inspections related to the component auditor has been provided by the group auditor’s firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor’s determination in paragraph 26(a).
- 27. The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor if:
  - (a) The component auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement;<sup>18</sup> or (Ref: Para. A66–A67)
  - (b) The group engagement partner has serious concerns about the matters in paragraphs 23–26. (Ref: Para. A68)

*Engagement Performance*

- 28. In applying proposed QM SAS,<sup>19</sup> the group engagement partner should take responsibility for the nature, timing and extent of direction and supervision of component auditors and the review of their work, taking into account: (Ref: Para. A69–A74)
  - (a) Areas of higher assessed risks of material misstatement of the group financial statements, or

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<sup>16</sup> Paragraph 17 of proposed QM SAS

<sup>17</sup> Paragraphs 25-26 of proposed QM SAS

<sup>18</sup> Paragraph 16 of AU-C section 200

<sup>19</sup> Paragraph 29 of proposed QM SAS

significant risks identified in accordance with AU-C section 315; and

- (b) Areas in the audit of the group financial statements that involve significant judgment.

**Communications with Component Auditors**

29. The group auditor should communicate with component auditors about their respective responsibilities and the group auditor's expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit. (Ref: Para. A75–A84)

**Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control**

30. In applying AU-C section 315,<sup>20</sup> the group auditor should take responsibility for obtaining an understanding of the following: (Ref: Para. A85–A89)

- (a) The group and its environment, including: (Ref: Para. A90–A92)
  - (i) The group's organizational structure and its business model, including:
    - a. The locations in which the group has its operations or activities;
    - b. The nature of the group's operations or activities and the extent to which they are similar across the group; and
    - c. The extent to which the group's business model integrates the use of IT;
  - (ii) Regulatory factors impacting the entities and business units in the group; and
  - (iii) The measures used internally and externally to assess the entities or business units' financial performance;
- (b) The applicable financial reporting framework and the consistency of accounting policies and practices across the group; and
- (c) The group's system of internal control, including:
  - (i) The nature and extent of commonality of controls; (Ref: Para. A93–A97, A100)
  - (ii) Whether, and if so, how, the group centralizes activities relevant to financial reporting; (Ref: Para. A98–A100)
  - (iii) The consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments; and
  - (iv) How group management communicates significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group's system of internal control to management of entities or business units. (Ref: Para. A101–A103)

*Considerations When Component Auditors Are Involved*

31. The group auditor should communicate to component auditors on a timely basis: (Ref: Para. A104)
- (a) Matters that the group auditor determines to be relevant to the component auditor's design or performance of risk assessment procedures for purposes of the group audit, including identified

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<sup>20</sup> Paragraphs 19-31 of AU-C section 315

significant risks of material misstatement of the group financial statements;

- (b) In applying AU-C section 550,<sup>21</sup> related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor; and (Ref: Para. A105)
- (c) In applying AU-C section 570 (Revised),<sup>22</sup> events or conditions identified by group management or the group auditor, that may cast significant doubt on the group's ability to continue as a going concern that are relevant to the work of the component auditor.

32. The group auditor should request component auditors to communicate on a timely basis:

- (a) Matters related to the financial information of the component that the component auditor determines to be relevant to the identification and assessment of the risks of material misstatement of the group financial statements, whether due to fraud or error;
- (b) Related party relationships not previously identified by group management or the group auditor; and
- (c) Any events or conditions identified by the component auditor that may cast significant doubt on the group's ability to continue as a going concern.

### **Identifying and Assessing the Risks of Material Misstatement**

33. In applying AU-C section 315,<sup>23</sup> based on the understanding obtained in paragraph 30, the group auditor should take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements, including with respect to the consolidation process. (Ref: Para. A106–A111)

### *Considerations When Component Auditors Are Involved*

34. In applying AU-C section 315,<sup>24</sup> the group auditor should evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements. (Ref: Para. A112–A113)

### **Materiality**

35. In applying AU-C section 320<sup>25</sup> and AU-C section 450,<sup>26</sup> when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, for those components on which the group auditor or component auditor will perform audit procedures, the group auditor should determine:

- (a) Component performance materiality. To address aggregation risk, such amount should be lower than group performance materiality. (Ref: Para. A114–A118)
- (b) The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor. Such threshold should not exceed the amount

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<sup>21</sup> Paragraph 19 of AU-C section 550, *Related Parties*

<sup>22</sup> AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

<sup>23</sup> Paragraphs 32-38 of AU-C section 315

<sup>24</sup> Paragraph 39 of AU-C section 315

<sup>25</sup> Paragraph 11 of AU-C section 320

<sup>26</sup> Paragraph 5 of AU-C section 450, *Evaluation of Misstatements Identified During the Audit*

regarded as clearly trivial to the group financial statements. (Ref: Para. A119)

*Considerations When Component Auditors Are Involved*

36. The group auditor should communicate to the component auditor the amounts determined in accordance with paragraph 35. (Ref: Para: A120–A121)

**Responding to the Assessed Risks of Material Misstatement**

37. In applying AU-C section 330,<sup>27</sup> the group auditor should take responsibility for the nature, timing, and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing, and extent of the work to be performed at those components. (Ref: Para. A122–A137)

*Consolidation Process*

38. The group auditor should take responsibility for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This should include: (Ref: Para. A138)
- (a) Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub-consolidations;
  - (b) Evaluating the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications; (Ref: Para. A139)
  - (c) Evaluating whether management's judgments made in the consolidation process give rise to indicators of possible management bias; and
  - (d) Responding to assessed risks of material misstatement due to fraud arising from the consolidation process.
39. If the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group auditor should evaluate whether the financial information has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework.
40. If the group financial statements include the financial information of an entity or business unit with a financial reporting period-end that differs from that of the group, the group auditor should take responsibility for evaluating whether appropriate adjustments have been made to that financial information in accordance with the applicable financial reporting framework.

*Considerations When Component Auditors Are Involved*

41. When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor should communicate with the component auditor about matters that the group auditor or component auditor determine to be relevant to the design of responses to the assessed risks of material misstatement of the group financial statements.
42. For areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with AU-C section 315, on which a component auditor is determining the further audit procedures to be performed, the group auditor should evaluate the

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<sup>27</sup> Paragraphs 6-7 of AU-C section 330

appropriateness of the design and performance of those further audit procedures. (Ref: Para. A140)

43. When component auditors perform further audit procedures on the consolidation process, including on sub-consolidations, the group auditor should determine the nature and extent of direction and supervision of component auditors and the review of their work. (Ref: Para. A141)
44. The group auditor should determine whether the financial information identified in the component auditor's communication (see paragraph 45(a)) is the financial information that is incorporated in the group financial statements.

**Evaluating the Component Auditor's Communications and the Adequacy of Their Work**

45. The group auditor should request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include: (Ref: Para. A142)
  - (a) Identification of the financial information on which the component auditor has been requested to perform audit procedures;
  - (b) Whether the component auditor has performed the work requested by the group auditor;
  - (c) Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement;
  - (d) Information about instances of non-compliance with laws or regulations;
  - (e) Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph 36; (Ref: Para. A143)
  - (f) Indicators of possible management bias;
  - (g) Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed;
  - (h) Fraud or suspected fraud involving component management, employees at entities or business units who have significant roles in the group's system of internal control at the component or others at entities or business units where the fraud resulted in a material misstatement of the component financial information;
  - (i) Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component;
  - (j) Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in the written representations that the component auditor requested from component management; and
  - (k) The component auditor's overall findings or conclusions. (Ref: Para. A144)
46. The group auditor should:
  - (a) Discuss significant findings and issues arising from communications with the component auditor, including those in accordance with paragraph 45, with the component auditor, component management or group management, as appropriate; and
  - (b) Evaluate whether communications with the component auditor are adequate for the group auditor's purposes. If such communications are not adequate for the group auditor's purposes,

the group auditor shall consider the implications for the group audit. (Ref: Para. A144A)

47. The group auditor should determine whether, and the extent to which, it is necessary to review additional component auditor audit documentation. In making this determination, the group auditor should consider: (Ref: Para. A145–A146)
- (a) The nature, timing and extent of the work performed by the component auditor;
  - (b) The competence and capabilities of the component auditor as determined in accordance with paragraph 26(a); and
  - (c) The direction and supervision of the component auditor and review of their work.
48. If the group auditor concludes that the work of the component auditor is not adequate for the group auditor’s purposes, the group auditor should determine what additional audit procedures are to be performed, and whether they are to be performed by a component auditor or by the group auditor.

**Subsequent Events**

49. In applying AU-C section 560,<sup>28</sup> the group auditor should take responsibility for performing procedures, including, as appropriate, requesting component auditors to perform procedures, designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: Para. A147)

*Considerations When Component Auditors Are Involved*

50. The group auditor should request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements. (Ref: Para. A147)

**Making Reference to the Audit of a Referred-to Auditor in the Auditor’s Report on the Group Financial Statements**

*Understanding the Referred-To Auditor*

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors

- 50.1 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for: (Ref: Para. A56–A57, A84, A147.2)
- (a) Referred-to auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and
  - (b) Confirming whether the referred-to auditors understand and will comply with the ethical requirements that are relevant to the group audit engagement, including those related to independence.

Competence and Capabilities of Referred-To Auditors

- 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
  - (b) If information about the results of the monitoring and remediation process or external inspections related to the referred-to auditor has been provided by the group auditor’s firm or

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<sup>28</sup> Paragraphs 9-10 of AU-C section 560, *Subsequent Events*

has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor's determination in paragraph 50.2(a). (Ref: Para. A147.3-A147.3.2)

- 50.3. The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements if: (Ref: Para. A67–A68)
- (a) The referred-to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.
  - (b) The group engagement partner has serious concerns about the matters in paragraphs 50.1-50.2.

*The Consolidation Process*

50.3.1 The group auditor should obtain an understanding of whether the group auditor will be able to obtain information affecting the consolidation process from group management or a referred-to auditor.

*Determining Whether to Make Reference (Ref: Para. A147.4-A147.9.)*

50.4. Having obtained an understanding of the referred-to auditor, the group engagement partner should determine whether to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

50.5 Reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless:

- (a) the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS (Ref: Para. A147.5), and
- (b) the referred-to auditor has issued an auditor's report that is not restricted as to use.

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

- (a) the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group, and
- (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 be involved in the work of the auditor. (Ref: Para. A147.5-A147.9)

50.5.2 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the group engagement team should obtain sufficient appropriate audit evidence with regard to such components by performing the following procedures:

- a. The procedures required by this proposed SAS related to making reference to the audit of a referred-to auditor.

- b. Reading the component's financial statements and the referred-to auditor's report thereon to identify significant findings and issues.

*Making Reference (Ref: Para. A147.10-A147.12)*

50.6 When the group engagement partner determines to make reference, the report on the group financial statements should clearly indicate

- (a) that the component was not audited by the group auditor but was audited by the referred-to auditor.
- (b) the magnitude of the portion of the financial statements audited by the referred-to auditor.
- (c) when the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements
  - (i) the financial reporting framework used by the component and
  - (ii) that the group auditor is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group in accordance with paragraph 39. (Ref: Para. A147.6)
- (d) when
  - (i) the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and
  - (ii) the group engagement partner has determined that the referred-to auditor performed additional audit procedures in order to meet the relevant requirements of GAAS
    - (a) the set of auditing standards used by the referred-to auditor and
    - (b) that additional audit procedures were performed by the referred-to auditor to meet the relevant requirements of GAAS.

50.7 If the group engagement partner determines to name a referred-to auditor in the auditor's report on the group financial statements:

- (a) the referred-to auditor's express permission should be obtained.
- (b) the referred-to auditor's report should be presented together with that of the auditor's report on the group financial statements.

50.8 If the opinion of a referred-to auditor is modified or that audit report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section, the group auditor should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the group auditor should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section in the auditor's report on the group financial statements. (Ref. Para. AA147.13)

*Communications With the Referred-To Auditor*

50.9 The group auditor should communicate to a referred-to auditor on a timely basis:

- a. In accordance with paragraph 50.1, the ethical requirements that are relevant to the group audit engagement, including those related to independence.

- b. In applying AU-C section 550,<sup>29</sup> related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the referred-to auditor.
- c. Identified significant risks of material misstatement of the group financial statements, whether due to fraud or error, that are relevant to the work of the referred-to auditor.
- d. A request that the referred-to auditor communicate on a timely basis:
  - i. Confirmation that the referred-to auditor will cooperate with the group auditor.
  - ii. Related party relationships not previously identified by group management or the group auditor. Additionally, the group engagement team should identify such additional related parties to other component auditors and referred-to auditors, as applicable;
  - iii. If the group engagement partner decides to name a component,
  - iv. express permission for the group engagement partner to name a referred-to auditor in the auditor's report on the group financial statements in accordance with paragraph 50.7(a).

50.10 The group auditor should request a referred-to auditor to communicate matters relevant to the group auditor's conclusion, with regard to the group audit. Such communication should include the following:

- a. Whether the referred-to auditor has complied with ethical requirements that are relevant to the group audit engagement, including independence
- b. Identification of the financial information of the component on which the referred-to auditor is reporting
- c. The referred-to auditor's audit report and opinion.

#### Evaluating a Referred-To Auditor's Communication

50.11 The group auditor should evaluate a referred-to auditor's communication (see paragraph 50.9(d) and 50.10). The group auditor should discuss significant findings and issues arising from that evaluation with the referred-to auditor, component management, or group management, as appropriate.

50.12 The group auditor should determine whether the financial information identified in the referred-to auditor's communications (see paragraph 50.10(b)) is the financial information that is incorporated in the group financial statements.

#### Subsequent Events

50.13 The group auditor should take responsibility for requesting referred-to auditors, as appropriate, to perform procedures designed to identify events that may require adjustment of, or disclosure in, the group financial statements.

#### **Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

51. In applying AU-C section 330,<sup>30</sup> the group auditor should evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including from the work performed by component auditors or through making reference to the audit of a referred-to auditor in

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<sup>29</sup> Paragraph 19 of AU-C section 550, *Related Parties*

<sup>30</sup> Paragraph 28 of AU-C section 330

the auditor's report on the group financial statements (paragraph 58.11-58.13), on which to base the group audit opinion. (Ref: Para. A148–A152)

52. The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) and any instances when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: Para. A153)

**Communication with Group Management and Those Charged with Governance of the Group**

*Communication with Group Management*

54. The group auditor should communicate with group management an overview of the planned scope and timing of the audit, including an overview of the work to be performed at components of the group. (Ref: Para. A156)
55. If fraud has been identified by the group auditor or brought to its attention by a component auditor (see paragraph 45(h)), or information indicates that a fraud may exist, the group auditor should communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. A157)
56. When a component auditor has been engaged to express an audit opinion on the financial statements of an entity or business unit that forms part of the group, the group auditor should request group management to inform management of the entity or business unit of any matter of which the group auditor becomes aware that may be significant to the financial statements of the entity or business unit, but of which management of the entity or business unit may be unaware. If group management refuses to communicate the matter to management of the entity or business unit, the group auditor should discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group auditor, subject to legal and professional confidentiality considerations, should consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the entity or business unit until the matter is resolved and whether to withdraw from the engagement. (Ref: Para. A158–A159)

*Communication with Those Charged with Governance of the Group*

57. The group auditor should communicate the following matters with those charged with governance of the group, in addition to those required by AU-C section 260, *Communication with Those Charged with Governance*<sup>31</sup> and other AU-C sections: (Ref: Para. A160)
- (a) An overview of the work to be performed at the components of the group, including the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, and the nature of the group auditor's planned involvement in the work to be performed by component auditors. (Ref: Para. A161)
  - (b) Instances when the group auditor's review of the work of a component auditor gave rise to a concern about the quality of that component auditor's work, and how the group auditor addressed the concern.
  - (c) Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information.
  - (d) Fraud or suspected fraud involving group management, component management, employees at entities or business units who have significant roles in the group's system of internal control

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<sup>31</sup> AU-C section 260, *Communication with Those Charged with Governance*

or others at entities or business units in which a material misstatement of the group financial statements has or may have resulted from fraud.

*Communication of Identified Deficiencies in Internal Control*

58. In applying AU-C section 265, *Communicating Internal Control Related Matters identified in an Audit*<sup>32</sup> the group auditor should determine whether any identified deficiencies in the group's system of internal control are required to be communicated to those charged with governance of the group or group management. In making this determination, the group auditor should consider deficiencies in internal control that have been identified by component auditors and communicated to the group auditor in accordance with paragraph 45(g). (Ref: Para. A162)

**Documentation**

59. In accordance with AU-C section 230,<sup>33</sup> the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying AU-C section 230,<sup>34</sup> the group auditor should include in the audit documentation the following: (Ref: Para. A163–A166, A176–A179)

- (a) Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed.
- (b) The basis for the group auditor's determination of components for purposes of planning and performing the group audit. (Ref: Para. A167)
- (c) The basis for the determination of component performance materiality and the threshold for communicating misstatements in the component financial information to the group auditor.
- (d) The basis for the group auditor's determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components. (Ref: Para. A168)
- (e) Key elements of the understanding of the group's system of internal control in accordance with paragraph 30(c);
- (f) The nature, timing and extent of the group auditor's direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor's review of additional component auditor audit documentation in accordance with paragraph 47. (Ref: Para. A169–A175)
- (g) Matters related to communications with component auditors, including:
  - (i) Matters, if any, related to fraud, related parties, or going concern communicated in accordance with paragraph 32.
  - (ii) Matters relevant to the group auditor's conclusion with regard to the group audit, in accordance with paragraph 45, including how the group auditor has addressed significant matters discussed with component auditors, component management or

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<sup>32</sup> AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* t

<sup>33</sup> Paragraph 8 of AU-C section 230

<sup>34</sup> Paragraphs 1-3 , 9-12, A8-A9, and the Exhibit in AU-C section 230

group management.

(g.1) Those components for which reference to the audit of referred-to auditors is made in the auditor's report on the group financial statements.

(g.2) For those components for which reference to the audit of referred-to auditors is made in the auditor's report on the group financial statements

- i. the financial statements of the component and the report of the referred-to auditor thereon
- ii. when the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the referred-to auditor met the relevant requirements of GAAS
- iii. The basis for the group auditor's determination that referred-to auditors have the appropriate competence and capabilities
- iv. Matters related to communications with referred-to auditors communicated in accordance with paragraphs 50.9(d) and 50.10, including how the group auditor has addressed significant matters discussed with referred-to auditors, component management or group management.

(h) The group auditor's evaluation of, and response to, findings or conclusions of the component auditors or referred-to auditors about matters that could have a material effect on the group financial statements.

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## Application and Other Explanatory Material

### Scope of this Proposed SAS (Ref: Para. 1–2)

- A1. This proposed SAS also addresses the special considerations for the group engagement partner or group auditor, as applicable, in applying the requirements and guidance in proposed QM SAS, including for the direction and supervision of component auditors and the review of their work.
- A2. Proposed Statement on Quality Management Standards (SQMS) 1, *A Firm's System of Quality Management*,<sup>35</sup> addresses the engagements for which an engagement quality review is required to be performed. Proposed SQMS 2, *Engagement Quality Reviews*,<sup>36</sup> addresses the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review, including for a group audit.
- A3. An entity or business unit of a group may also prepare its own group financial statements that incorporate the financial information of those entities or business units it encompasses (that is, a sub-group). This proposed SAS applies to an audit of the group financial statements of such sub-groups performed for legal, regulatory, or other reasons.
- A4. A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a bank with multiple branches. When those business units have characteristics such as separate locations, separate management, or separate information

<sup>35</sup> Proposed Statement on Quality Management Standards (SQMS) 1, *A Firm's System of Quality Management*

<sup>36</sup> Proposed SQMS 2, *Engagement Quality Reviews*

systems (including a separate general ledger) and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.

- A5. In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this proposed SAS.

*Groups and Components (Ref: Para. 4–5)*

- A6. The group's information system, including its financial reporting process, may or may not be aligned with the group's organizational structure. For example, a group may be organized according to its legal structure, but its information system may be organized by function, process, product, or service (or by groups of products or services), or geographic locations for management or reporting purposes.
- A7. Based on the understanding of the group's organizational structure and information system, the group auditor may determine that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the group auditor may decide to treat these three legal entities as one component.
- A8. A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example through the use of a shared service center. When such centralized activities are relevant to the group's financial reporting process, the group auditor may determine that the shared service center is a component.
- A9. Another consideration that may be relevant to the group auditor's determination of components is how management has determined operating segments in accordance with the disclosure requirements of the applicable financial reporting framework.<sup>37</sup>

*Involvement of Component Auditors (Ref: Para. 6–8)*

- A10. Component auditors may perform an audit of the financial statements of a component, whether for legal, regulatory, or other reasons, particularly when a component is a legal entity. When a component auditor is also performing or has completed an audit of the component financial statements, the group auditor may be able to use audit work performed on the component financial statements, provided the group auditor is satisfied that such work is appropriate for purposes of the group audit. In addition, component auditors may adapt the work performed on the audit of the component financial statements to also meet the needs of the group auditor. 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.
- A10A. In accordance with ISA 220 (Revised),<sup>38</sup> the engagement partner is required to determine that the

<sup>37</sup> See, for example, FASB Accounting Standards Codification Manual (ASC FASB Accounting Standards Codification Manual (ASC) 280, *Segment Reporting*

<sup>38</sup> ISA 220 (Revised), paragraph 30(b)

approach to direction, supervision and review is responsive to the nature and circumstances of the audit engagement. Paragraph A73 provides examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work, and may be helpful in circumstances when the group auditor plans to use the audit work from an audit of component financial statements that has already been completed.

- A11. As explained in AU-C section 200,<sup>39</sup> detection risk relates to the nature, timing and extent of the auditor’s procedures that are determined by the auditor to reduce audit risk to an acceptably low level. Detection risk is a function not only of the effectiveness of an audit procedure but also the application of that procedure by the auditor. Therefore, detection risk is influenced by matters such as adequate planning, the assignment of appropriate resources to the engagement, the exercise of professional skepticism, and the supervision and review of the audit work performed.
- A12. Detection risk is a broader concept than aggregation risk as described in paragraphs 14(a) and A18. In a group audit, there may be a higher probability that the aggregate of uncorrected and undetected misstatements may exceed materiality for the group financial statements as a whole because audit procedures may be performed separately on the financial information of components across the group. Accordingly, component performance materiality is set by the group auditor to reduce aggregation risk to an appropriately low level.

*Making Reference to the Audit of a Referred-To Auditor*

A12.1 When component auditors are involved in the audit of the group financial statements, no reference is made to the component auditor in the report on the group audit because to do so may cause a reader to misinterpret the degree of responsibility of the group auditor.

*Professional Skepticism (Ref: Para. 9)*

- A13. Proposed QM SAS<sup>40</sup> provides examples of the impediments to the exercise of professional skepticism at the engagement level, including unconscious auditor biases that may impede the exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Proposed QM SAS also provides possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level.
- A14. Requirements and relevant application material in AU-C section 315,<sup>41</sup> AU-C section 540<sup>42</sup> and other AU-C sections address the exercise of professional skepticism, and include examples of how documentation may help provide evidence of the auditor’s exercise of professional skepticism.
- A15. All members of the engagement team are required to exercise professional skepticism throughout the group audit. The group auditor’s direction and supervision of engagement team members, including component auditors, and the review of their work, may inform the group auditor about whether the engagement team has appropriately exercised professional skepticism.
- A16. The exercise of professional skepticism in a group audit may be affected by matters such as the following:
- Component auditors in different locations may be subject to varying cultural influences, which may affect the nature of the biases to which they are subject.

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<sup>39</sup> Paragraph A49 of AU-C section 200

<sup>40</sup> Paragraphs A34-A36 of proposed QM SAS

<sup>41</sup> Paragraph A268 of AU-C section 315

<sup>42</sup> Paragraph A11 of SAS No. , *Auditing Accounting Estimates and Related Disclosures*

- The complex structure of some groups may introduce factors that give rise to increased susceptibility to risks of material misstatement. In addition, an overly complex organizational structure may be a fraud risk factor in accordance with AU-C section 240<sup>43</sup> and therefore may require additional time or expertise to understand the business purpose and activities of certain entities or business units.
- The nature and extent of intra-group transactions (e.g., transactions that involve multiple entities and business units within the group or multiple related parties), cash flows or transfer pricing agreements may give rise to additional complexities. In some cases, such matters may also give rise to fraud risk factors.
- When the group audit is subject to tight reporting deadlines, this may put pressure on engagement team members when completing the work assigned. In these circumstances, the engagement team may need to take additional time to appropriately question management’s assertions, make appropriate judgments, or appropriately review the audit work performed.

A17. The exercise of professional skepticism by the group auditor includes remaining alert for inconsistent information from component auditors, component management and group management about matters that may be significant to the group financial statements.

*Responsibilities of the Group Engagement Partner and Group Auditor (Ref: Para. 11)*

A17.1. Component auditors or referred-to auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings or conclusions. However, regardless of whether reference is made in the auditor’s report on the group financial statements to the report of a referred-to auditor, the group engagement partner or the group engagement partner’s firm is responsible for the group audit opinion.

A17.2. When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Qualified Opinion or Basis for Disclaimer of Opinion section in the auditor’s report on the group financial statements describes the reasons for that inability.<sup>44</sup> In some circumstances, a reference to a component auditor or referred-to auditor may be necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.

A17.3. When the group auditor is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements, the auditor’s reporting responsibilities with respect to the separate financial statements are the same as the auditor’s responsibilities with respect to the group financial statements.

**Definitions**

*Aggregation Risk (Ref: Para. 14(a))*

A18. Aggregation risk exists in all audits of financial statements, but is particularly important to understand and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances or disclosures that are disaggregated across

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<sup>43</sup> Appendix A of AU-C section 240, *Consideration of o Fraud in a Financial Statement Audis*,

<sup>44</sup> Paragraphs 21 and 25 of AU-C section 705

components. Generally, aggregation risk increases as the number of components increases at which audit procedures are performed separately, whether by component auditors or other members of the engagement team, or by referred-to auditors.

*Component* (Ref: Para. 14(b))

A19. The group auditor uses professional judgment in determining components at which audit work will be performed. Paragraph A7 explains that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. However, the group auditor's responsibility for the identification and assessment of the risks of material misstatement of the group financial statements encompasses all of the entities and business units whose financial information is included in the group financial statements.

*Considerations Specific to Governmental Entities* (Ref: Para. 14(b))

A19.1. In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

*Component Auditor* (Ref: Para. 14(c))

A20. References in this proposed SAS to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).

A20.1 An auditor who performs work on a component when the group auditor will not use that work to provide audit evidence for the group audit is not considered a component auditor.

A21. In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

A21A. Paragraph 24 requires the group auditor to request the component auditor to confirm that the component auditor will cooperate with the group auditor and perform the work requested by the group auditor. Paragraph A55 provides guidance for circumstances in which the component auditor is unable to provide such a confirmation.

*Component Management* (Ref: Para. 14(d))

A22. Component management refers to management responsible for the financial information or other activity (e.g., processing of transactions at a shared service center) at an entity or business unit that is part of the group. When the group auditor considers the financial information of certain entities or business units together as a component or determines that a shared service center is a component (see paragraphs A7–A8), component management refers to the management that is responsible for the financial information or transaction processing that is subject to the audit procedures being performed in relation to that component. In some circumstances, there may not be separate component management and group management may be directly responsible for the financial information or other activities of the component.

*Group Engagement Partner* (Ref: Para. 14(j))

A23. When joint auditors conduct a group audit, the joint engagement partners and their engagement teams collectively constitute the "group engagement partner" and "engagement team" for the purposes of GAAS. This proposed SAS does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor for purposes of the group audit.

*Group Financial Statements* (Ref: Para. 2, 14(k))

- A24. The requirements for the preparation and presentation of the group financial statements may be specified in the applicable financial reporting framework, which may therefore affect the determination of the financial information of entities or business units to be included in the group financial statements. For example, some frameworks require the preparation of consolidated financial statements when an entity (a parent entity) controls one or more other entities (e.g., subsidiaries) through majority ownership interest or other means. In some cases, the applicable financial reporting framework includes separate requirements for, or may otherwise permit, the presentation of combined financial statements. Examples of circumstances in which the presentation of combined financial statements may be permitted include entities that are under common control or entities under common management.
- A25. The term “consolidation process” as used in this proposed SAS is not intended to have the same meaning as “consolidation” or “consolidated financial statements” as defined or described in financial reporting frameworks. Rather, the term “consolidation process” refers more broadly to the process used to prepare group financial statements.
- A26. The detailed aspects of the consolidation process vary from one group to another, depending on the group’s structure and information system, including the financial reporting process. However, a consolidation process involves considerations such as the elimination of intra-group transactions and balances and, when applicable, implications of different reporting periods for entities or business units included in the group financial statements.

*Referred-To Auditor* (Ref: Para. 14(m.1))

- 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.

*Considerations Specific to Governmental Entities* (Ref: Para. 1, 15)

- A26.2 In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

**Leadership Responsibilities for Managing and Achieving Quality on a Group Audit** (Ref: Para. 11, 16)

- A27. It may not be possible or practical for the group engagement partner to solely deal with all requirements in proposed QM SAS, particularly when the engagement team includes a large number of component auditors located in multiple locations. In managing quality at the engagement level, proposed QM SAS<sup>45</sup> permits the engagement partner to assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the engagement partner. Accordingly, the group engagement partner may assign procedures, tasks, or actions to other members of the engagement team and these members may assign procedures, tasks, or actions further. In such circumstances, proposed QM SAS requires that the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement.
- A28. Policies or procedures established by the firm, or that are common network requirements or network services,<sup>46</sup> may support the group engagement partner by facilitating communication between the

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<sup>45</sup> Paragraph 15 of proposed QM SAS

<sup>46</sup> Paragraphs 49-53 of proposed SQMS 1

group auditor and component auditors and supporting the group auditor's direction and supervision of those component auditors and the review of their work.

A29. Proposed QM SAS <sup>47</sup> explains that a culture that demonstrates a commitment to quality is shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. In addressing the requirement in paragraph 16(a), the group engagement partner may communicate directly to other members of the engagement team (including component auditors) and reinforce this communication through personal conduct and actions (e.g., leading by example).

### **Acceptance and Continuance**

*Determining Whether Sufficient and Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained* (Ref: Para. 17–18)

A30. In determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, the group engagement partner may obtain an understanding of matters such as:

- The group structure, including both the legal and organizational structure.
- Activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place.
- The use of service organizations.
- The use of shared service centers.
- The consolidation process.
- Whether the group auditor:
  - Will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management and component information, including of those components that are accounted for by the equity method; and
  - Will be able to perform necessary work on the financial information of the components when applicable.
- Whether sufficient and appropriate resources are assigned or will be made available.

A31. In the case of an initial group audit engagement, the group auditor's understanding of the matters in paragraph A30 may be obtained from:

- Information provided by group management;
- Communication with group management;
- Communication with those charged with governance of the group; and
- When applicable, communication with component management or the predecessor auditor.

A32. For a recurring engagement, the ability to obtain sufficient appropriate audit evidence may be affected

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<sup>47</sup> Paragraph A28 of proposed QM SAS

by significant changes, for example, changes in:

- The group structure (e.g., acquisitions, disposals, joint ventures, reorganizations, or changes in how the group financial reporting system is organized).
- Components' activities that are significant to the group.
- The composition of those charged with governance of the group, group management, or key management of components for which audit procedures are expected to be performed.
- The group auditor's understanding of the integrity and competence of group or component management.
- Changes in the applicable financial reporting framework.

A33. There may be additional complexities with obtaining sufficient appropriate audit evidence in a group audit when components are located in jurisdictions other than the group auditor's jurisdiction because of cultural and language differences, and different laws or regulations. For example, law or regulation may restrict the component auditor from providing documentation outside of its jurisdiction, or war, civil unrest or outbreaks of disease may restrict the group auditor's access to relevant component auditor audit documentation. Paragraph A177 includes possible ways to address these situations.

A33.1. In addition to the work performed by the group auditor, the group engagement partner may obtain sufficient appropriate audit evidence regarding the financial information of one or more components through using the work of a component auditor or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

A33.2 There may be more complexities in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit where the audit report of a referred-to auditor is made reference to. The group engagement partner may consider the nature and extent of work performed by referred-to auditors, including matters such as:

- The financial significance of the components that are audited by referred-to auditors and for which the group auditor plans to make reference to in the auditor's report on the group financial statements.
- The risks of material misstatement associated with the portion of the company's financial statements for which the group auditor or component auditor performs audit procedures, in comparison with the portion audited by referred-to auditors.

A34. Restrictions may be imposed after the group engagement partner's acceptance of the group audit engagement that may affect the engagement team's ability to obtain sufficient appropriate audit evidence. Such restrictions may include those affecting:

- The group auditor's access to component information, management or those charged with governance of components, or the component auditors (including relevant audit documentation sought by the group auditor) (see paragraphs 20 and 21); or
- The work to be performed on the financial information of components.

Paragraphs A42–A43 explain the possible effect of such restrictions on the auditor's report on the group financial statements.

*Agreeing the Terms of Audit Engagements* (Ref: Para. 19)

A35. AU-C section 210<sup>48</sup> requires the auditor to agree the terms of the audit engagement with management or those charged with governance, as appropriate. The terms of engagement identify the applicable financial reporting framework. Additional matters that may be included in the terms of a group audit engagement include whether reference will be made in the audit of a referred-to auditor in the auditor’s report on the group financial statements, when relevant, or arrangements to facilitate the following:

- Unrestricted communications between the group auditor and component auditors, to the extent permitted by laws or regulations;
- Communications to the group auditor of important communications between
  - component auditors and those charged with governance of the component or component management, including communications on significant deficiencies and material weaknesses in internal control
  - regulatory authorities and entities or business units related to financial reporting matters that may be relevant to the group audit
- Permission for the group auditor to perform work, or request a component auditor to perform work, at the component.

*Restrictions on Access to Information or People* (Ref: Para. 20–21)

A36. Restrictions on access to information or people do not eliminate the requirement for the group auditor to obtain sufficient appropriate audit evidence.

A37. Access to information or people can be restricted for many reasons, such as restrictions imposed by component management, laws or regulations or other conditions, for example, war, civil unrest, or outbreaks of disease. Paragraph A177 describes how the group auditor may be able to overcome restrictions on access to component auditor audit documentation.

A38. In some circumstances, the group auditor may be able to overcome restrictions on access to information or people, for example:

- If access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the group.
- If the group has a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may determine whether provisions exist (e.g., in the terms of joint venture agreements, or the terms of other investment agreements) regarding access by the group to the financial information of the entity and request group management to exercise such rights.
- If the group has a non-controlling interest in an entity that is accounted for by the equity method and the group has representatives who are on the executive board or are members of those charged with governance of the non-controlled entity, the group auditor may inquire whether they can provide financial and other information available to them in these roles.

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<sup>48</sup> Paragraphs 9 and 10 ( e) of AU-C section 210)

A39. If the group has a non-controlling interest in an entity that is accounted for by the equity method and the group auditor's access to information or people at the entity is restricted, the group auditor may be able to obtain information to be used as audit evidence regarding the entity's financial information, for example:

- Financial information that is available from group management, as group management also needs to obtain the non-controlled entity's financial information in order to prepare the group financial statements.
- Publicly available information, such as audited financial statements, public disclosure documents, or quoted prices of equity instruments in the non-controlled entity.
- Financial statements audited by a referred-to auditor when the group auditor makes reference to the audit of a referred-to auditor in the group audit report.

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can obtain sufficient appropriate audit evidence.<sup>49</sup>

A39A. If the group has a non-controlling interest in an entity that is accounted for by the equity method and access to information or people at the entity is restricted, the group auditor may consider whether such restrictions are inconsistent with group management's assertions regarding the appropriateness of the use of the equity method of accounting.

A40. When the group auditor is unable to obtain sufficient appropriate audit evidence due to restrictions on access to information or people, the group auditor may:

- Communicate the restrictions to the group auditor's firm to assist the group auditor in determining an appropriate course of action. For example, the group auditor's firm may communicate with group management about the restrictions and encourage group management to communicate with regulators. This may be useful when restrictions affect multiple audits in the jurisdiction or by the same firm, for example, because of war, civil unrest, or outbreaks of disease in a major economy.
- Be required by law or regulation to communicate with regulators, listing authorities, or others, about the restrictions.

A41. Restrictions on access may have other implications for the group audit. For example, if restrictions are imposed by group management, the group auditor may need to reconsider the reliability of group management's responses to the group auditor's inquiries and whether the restrictions call into question group management's integrity.

*Effect of Restrictions on Access to Information or People on the Auditor's Report on Group Financial Statements*

A42. AU-C section 705<sup>50</sup> contains requirements and guidance about how to address situations when the group auditor is unable to obtain sufficient appropriate audit evidence. Appendix 1 contains an

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<sup>49</sup> Paragraph 7(b) of AU-C section 330

<sup>50</sup> AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*

example of an auditor's report containing a qualified group audit opinion based on the group auditor's inability to obtain sufficient appropriate audit evidence in relation to a component that is accounted for by the equity method.

*Law or Regulation Prohibit the Group Engagement Partner from Declining or Withdrawing from an Engagement*

A43. AU-C Section 210 addresses circumstances when an entity is required by law or regulation to have an audit. In these circumstances, this proposed SAS still applies to the group audit, and the effect of the group auditor's inability to obtain sufficient appropriate audit evidence is addressed in AU-C section 705 .

**Overall Group Audit Strategy and Group Audit Plan**

*The Continual and Iterative Nature of Planning and Performing a Group Audit (Ref: Para. 22)*

A44. As explained in AU-C section 300,<sup>51</sup> planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. For example, due to unexpected events, changes in conditions, or audit evidence obtained from risk assessment or further audit procedures, the group auditor may need to modify the overall group audit strategy and group audit plan, and the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The group auditor may also modify the determination of the components at which to perform audit work as well as the nature, timing, and extent of the component auditors' involvement. AU-C section 300<sup>52</sup> requires the auditor to update and change the overall audit strategy and audit plan as necessary during the course of the audit.

A44.1 The form of the group audit strategy and group audit plan may vary based on the nature and circumstances of each group audit engagement, including the extent to which engagement management is integrated into the audit tools used for the group audit. An electronic audit tool may be used to develop and update the group audit strategy and audit plan, and facilitate the group engagement partner's review of the group audit plan and group audit strategy.

*Establishing the Overall Group Audit Strategy and Group Audit Plan (Ref: Para. 22)*

A45. In an initial group audit engagement, the group auditor may have a preliminary understanding of the group and its environment, the applicable financial reporting framework and the entity's system of internal control based on information obtained from group management, those charged with governance of the group and, when applicable, communication with component management or the predecessor auditor. In a recurring group audit engagement, the group auditor's preliminary understanding may be obtained through prior period audits. This preliminary understanding may assist the group auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant.

A46. The group auditor may also use information obtained during the engagement acceptance and continuance process in establishing the overall group audit strategy and group audit plan, for example, in relation to the resources needed to perform the group audit.

A47. The process of establishing the overall group audit strategy and group audit plan and initial expectations about the classes of transactions, account balances and disclosures that may be significant at the group financial statement level may assist the group auditor in developing a

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<sup>51</sup> Paragraph A2 of AU-C section 300

<sup>52</sup> Paragraph 10 of AU-C section 300

preliminary determination of matters such as:

- Whether to perform audit work centrally, at components or a combination thereof; and
- The nature, timing, and extent of audit work to be performed with respect to the financial information of components (e.g., design and perform risk assessment procedures, further audit procedures, or a combination thereof).
- The components for which, if any, the auditor’s report on the group financial statements will make reference to the audit of a referred-to auditor.

*Components at Which to Perform Audit Work (Ref: Para. 22(a))*

A48. The determination of components at which to perform audit work is a matter of professional judgment. Matters that may influence the group auditor’s determination include, for example:

- The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example:
  - Newly formed or acquired entities or business units.
  - Entities or business units in which significant changes have taken place.
  - Significant transactions with related parties.
  - Significant transactions outside the normal course of business.
  - Abnormal fluctuations identified by analytical procedures performed at the group level, in accordance with AU-C section 315.<sup>53</sup>
- The disaggregation of significant classes of transactions, account balances and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities and transactions at the location or business unit relative to the group financial statements.
- Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances and disclosures in the group financial statements from audit work planned on the financial information of identified components.
- The nature and extent of misstatements or control deficiencies identified at a component in prior period audits.
- The nature and extent of the commonality of controls across the group and whether, and if so, how, the group centralizes activities relevant to financial reporting.

*Considerations Specific to Governmental Entities (Ref: Para. 22)*

A48.1. In audits of governmental entities, matters that may influence the group auditor’s determination of components at which to perform audit work include, for example, the disaggregation of significant classes of transactions, account balances and disclosures (e.g., net costs or total budget) in the group financial statements across components, considering the size and nature of assets, liabilities and transactions, at the component unit, business activity, department or program relative to the group financial statements. Qualitative considerations in audits of governmental entities may

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<sup>53</sup> Paragraph 14(b) of AU-C section 315

involve matters of heightened public sensitivity, such as national security issues, donor funded projects, or reporting of tax revenue.

*Resources* (Ref: Para. 22(b))

A49. Matters that influence the group auditor's determination of the resources needed to perform the group audit and the nature, timing and extent to which component auditors are to be involved are a matter of professional judgment and may include, for example:

- The understanding of the group, the components within the group at which audit work is to be performed and whether to perform work centrally, at components or a combination thereof.
- The knowledge and experience of the engagement team. For example, component auditors may have greater experience and a more in-depth knowledge than the group auditor of the local industries in which components operate, local laws or regulations, business practices, language, and culture. In addition, the involvement of auditor's specialists may be needed on complex matters.
- The initial expectations about the potential risks of material misstatement.
- The amount or location of resources to allocate to specific audit areas. For example, the extent to which components are dispersed across multiple locations may impact the need to involve component auditors in specific locations.
- Access arrangements. For example, when the group auditor's access to a component in a particular jurisdiction is restricted, component auditors may need to be involved.
- The nature of the components' activities, including their complexity or specialization of operations.
- The group's system of internal control, including the information system in place, and its degree of centralization. For example, the involvement of component auditors may be more likely when the system of internal control is decentralized.
- Previous experience with the component auditor.

A50. Component auditors may be involved in different phases of an audit, for example, component auditors may design or perform:

- Risk assessment procedures; and
- Procedures to respond to the assessed risks of material misstatement.

A51. The nature, timing and extent to which component auditors are to be involved depends on the facts and circumstances of the group audit engagement. Often component auditors will be involved in all phases of the audit, but the group auditor may decide to involve component auditors only in a certain phase. When the group auditor does not intend to involve component auditors in risk assessment procedures, the group auditor may still discuss with component auditors whether there are any significant changes in the business or the system of internal control of the component that could have an effect on the risks of material misstatement of the group financial statements.

- A52. AU-C section 300<sup>54</sup> requires the engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the group audit. The involvement of component auditors in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The group engagement partner uses professional judgment in determining which component auditors to involve in planning the audit. This may be affected by the nature, timing, and extent to which the component auditors are expected to be involved in designing and performing risk assessment or further audit procedures.
- A53. As described in proposed SQMS 1,<sup>55</sup> there may be circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm’s ability to perform the engagement in accordance with professional standards and applicable legal or regulatory requirements. The level of fees, including their allocation to component auditors, and the extent to which they relate to the resources required may be a special consideration for group audit engagements. For example, in a group audit, the firm’s financial and operational priorities may place constraints on the determination of the components at which audit work will be performed, as well as the resources needed, including the involvement of component auditors. In such circumstances, these constraints do not override the group engagement partner’s responsibility for achieving quality at the engagement level or the requirements for the group auditor to obtain sufficient appropriate audit evidence on which to base the group audit opinion.

*Considerations When Component Auditors Are Involved*

Sufficient and Appropriate Involvement in the Work of the Component Auditor (Ref: Para. 23–24)

- A54. In evaluating whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor, the group auditor may obtain an understanding of whether the component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor. The group auditor may also obtain an understanding about whether audit evidence related to components located in a different jurisdiction may be in a different language and may need to be translated for use by the group auditor.
- A55. If the component auditor is unable to cooperate with the group auditor, the group auditor may:
- Request the component auditor to provide its rationale.
  - Be able to take appropriate action to address the matter, including adjusting the nature of the work requested to be performed. Alternatively, in accordance with paragraph 27, the group auditor may need to obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: Para. 25)

- A56. When performing work at a component for a group audit engagement, the component auditor or the referred-to auditor are subject to ethical requirements, including those related to independence, that are relevant to the group audit engagement. Such requirements may be different from or in addition to those applying to the component auditor or the referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the component auditor’s jurisdiction. When the component auditor or the referred-to

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<sup>54</sup> Paragraph 5 of AU-C section 300

<sup>55</sup> Paragraph A78 of proposed SQMS 1

auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor or referred-to 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 or referred-to auditor's ethical responsibilities in the group audit.

- A57. In making the component auditor or the referred-to auditor aware of relevant ethical requirements, the group auditor may consider whether additional information or training for the component auditor or the referred-to auditor is necessary regarding the provisions of the ethical requirements that are relevant to the group audit engagement.

Engagement Resources (Ref: Para. 26)

- A58. Proposed QM SAS <sup>56</sup> requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. When sufficient or appropriate resources are not made available in relation to work to be performed by a component auditor, the group engagement partner may discuss the matter with the component auditor, group management or the group auditor's firm and may subsequently request the component auditor or the group auditor's firm to make sufficient and appropriate resources available.

Competence and capabilities of the component auditors

- A59. Proposed QM SAS <sup>57</sup> provides guidance regarding matters the engagement partner may take into consideration when determining the competence and capabilities of the engagement team. This determination is particularly important in a group audit when the engagement team includes component auditors. Proposed QM SAS <sup>58</sup> indicates that the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether a component auditor from another firm has the appropriate competence and capabilities to perform the audit engagement.
- A60. Determining whether component auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement. This determination influences the nature, timing and extent of the group engagement partner's direction and supervision of the component auditor and the review of their work.
- A61. In determining whether component auditors have the appropriate competence and capabilities to perform the assigned audit procedures at the component, the group engagement partner may consider matters such as:
- Previous experience with or knowledge of the component auditor.
  - The component auditor's specialized skills (e.g., industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies).
  - The component auditor's understanding of the auditing and other standards applicable to the group audit, such as GAAS that is sufficient to fulfill the component auditor's responsibilities.
  - The degree to which the group auditor and component auditor are subject to a common system of quality management, for example, whether the group auditor and a component auditor:

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<sup>56</sup> Paragraph 25 of proposed QM SAS

<sup>57</sup> Paragraph A71 of proposed QM SAS

<sup>58</sup> Paragraph A24 of proposed QM SAS

- Use common resources to perform the work (e.g., audit methodologies or information technology (IT) applications);
- Share common policies or procedures affecting engagement performance (e.g., direction, supervision and review of work or consultation);
- Are subject to common monitoring activities; or
- Have other commonalities, including common leadership or a common cultural environment.
- The consistency or similarity of:
  - Laws or regulations or legal system;
  - Language and culture;
  - Education and training;
  - Professional oversight, discipline, and external quality assurance; or
  - Professional organizations and standards.
- Information obtained about the component auditor through interactions with component management, those charged with governance, and other key personnel, such as internal auditors.

A62. The procedures to determine the component auditor’s competency and capability may include, for example:

- An evaluation of the information communicated by the group auditor’s firm to the group auditor, including:
  - The firm’s ongoing communication related to monitoring and remediation, in circumstances when the group auditor and component auditor are from the same firm.<sup>59</sup>
  - Information from the network about the results of the monitoring activities undertaken by the network across the network firms.<sup>60</sup>
  - Information obtained from professional body(ies) to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.
- Discussing the assessed risks of material misstatement with the component auditor.
- Requesting the component auditor to confirm their understanding of the matters referred to in paragraph 25 in writing.
- Discussing the component auditor’s competence and capabilities with colleagues in the group engagement partner’s firm that have worked directly with the component auditor.
- Obtaining published external inspection reports, peer review reports on the component auditor’s firm and other relevant publicly available information relating to the professional

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<sup>59</sup> Paragraph 48 of proposed SQMS 1

<sup>60</sup> Paragraph 52(b) of proposed SQMS 1

reputation and standing of a component auditor.

A63. The group engagement partner’s firm and the component auditor may be members of the same network and may be subject to common network requirements or use common network services.<sup>61</sup> When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such network requirements, for example, those addressing professional training, or recruitment or that require the use of audit methodologies and related implementation tools. In accordance with proposed SQMS 1,<sup>62</sup> the firm is responsible for designing, implementing, and operating its system of quality management, and the firm may need to adapt or supplement network requirements or network services to be appropriate for use in its system of quality management.

Using the work of an auditor’s specialist

A64. Proposed QM SAS <sup>63</sup> requires the engagement partner to determine that members of the engagement team, and any auditor’s external specialists who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. If an auditor’s specialist is used by a component auditor, the group engagement partner may need to obtain information from the component auditor. For example, the group auditor may discuss with the component auditor, the component auditor’s evaluation of the competence and capabilities of the auditor’s specialist.

Automated tools and techniques

A65. When determining whether the engagement team has the appropriate competence and capabilities, the group engagement partner may take into consideration such matters as the expertise of the component auditor in the use of automated tools and techniques. For example, as described in proposed QM SAS ,<sup>64</sup> when the group auditor requires component auditors to use specific automated tools and techniques when performing audit procedures, the group auditor may communicate with component auditors that the use of such automated tools and techniques need to comply with the group auditor’s instructions.

Application of the Group Auditor’s Understanding of a Component Auditor (Ref: Para. 27)

A66. Proposed QM SAS <sup>65</sup> requires the engagement partner to take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm’s related policies or procedures. This includes the firm’s policies or procedures that address circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches. The firm’s policies or procedures also may address breaches of independence requirements by component auditors, and actions the group auditor may take in those circumstances in accordance with the relevant ethical requirements. In addition, relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances when breaches of independence requirements have been identified.<sup>66</sup>

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<sup>61</sup> Paragraphs A20 and A187 of Proposed SQMS 1,

<sup>62</sup> Paragraphs 49-50 of proposed SQMS 1

<sup>63</sup> Paragraph 26 of proposed QM SAS

<sup>64</sup> Paragraph A65 of proposed QM SAS 220

<sup>65</sup> Paragraph 17 of proposed QM SAS

<sup>66</sup> Paragraph A17 of AU-C section 260

- A67. If there has been a breach by a component auditor or a referred-to auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot use the work of that component auditor or make reference in the auditor's report on the group financial statements to the audit of that auditor.
- A68. Serious concerns are those concerns that in the group auditor's professional judgment cannot be overcome. The group engagement partner may be able to overcome less than serious concerns about the component auditor's or the referred-to auditor's professional competency (e.g., lack of industry-specific knowledge), or the fact that the component auditor or referred-to auditor does not operate in an environment that actively oversees auditors, by directly performing further audit procedures on the financial information of the component, or by the group auditor being more involved in the work of the component auditor, or by making reference in the auditor's report on the group financial statements to the audit of that e referred-to auditor..

Engagement Performance (Ref: Para. 28)

- A69. Proposed QM SAS <sup>67</sup> requires the engagement partner to determine that the nature, timing, and extent of direction, supervision, and review is planned and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements, and is responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team. For a group audit, the approach to direction, supervision and review will generally include a combination of addressing the group auditor's firm policies or procedures and group audit engagement specific responses.
- A70. For a group audit, particularly when the engagement team includes a large number of component auditors that may be located in multiple locations, the group engagement partner may assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the group engagement partner in fulfilling the responsibility for the nature, timing and extent of the direction and supervision of component auditors and the review of their work. (see also paragraph 11).
- A71. If component auditors are from a firm other than the group auditor's firm, the firm's policies or procedures may be different, or different actions may need to be taken, respectively, in relation to the nature, timing and extent of direction and supervision of those members of the engagement team, and the review of their work. In particular, firm policies or procedures may require the firm or the group engagement partner to take different actions from those applicable to members of the engagement team within the firm or the network (e.g., in relation to the form, content and timing of communications with component auditors, including the use of group auditor instructions to component auditors). Proposed QM SAS provides examples of actions that may need to be taken in such circumstances.<sup>68</sup>
- A72. The nature, timing and extent of direction and supervision of component auditors and review of their work may be tailored based on the nature and circumstances of the engagement and, for example:
- The assessed risks of material misstatement. For example, if the group auditor has identified a component that includes a significant risk, an increase in the extent of direction and supervision of the component auditor and a more detailed review of the component auditor's audit documentation may be appropriate.

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<sup>67</sup> Paragraph 30 of proposed QM SAS

<sup>68</sup> Paragraphs A24-A25 of proposed QM SAS

- The competence and capabilities of the component auditors performing the audit work. For example, if the group auditor has no previous experience working with a component auditor, the group auditor may communicate more detailed instructions, increase the frequency of discussions or other interactions with the component auditor, or assign more experienced individuals to oversee the component auditor as the work is performed.
- The location of engagement team members, including the extent to which engagement team members are dispersed across multiple locations, including when service delivery centers are used.
- Access to component auditor audit documentation. For example, when law or regulation precludes component auditor audit documentation from being transferred out of the component auditor's jurisdiction, the group auditor may be able to review the audit documentation at the component auditor's location or remotely through the use of technology, when not prohibited by law or regulation (see also paragraphs A176–A177).

A73. There are different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work, for example:

- Communications with component auditors throughout the course of the group audit, including communications required by this proposed SAS;
- Meetings or calls with component auditors to discuss identified and assessed risks, issues, findings, and conclusions.
- Reviews of the component auditor's audit documentation in person or remotely when permitted by law and regulation.
- Participating in the closing or other key meetings between the component auditors and component management.

A74. In applying proposed QM SAS,<sup>69</sup> the group engagement partner is required to review audit documentation at appropriate points in time during the audit engagement, including audit documentation relevant to the group audit relating to:

- Significant matters;
- Significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
- Other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

The review of such audit documentation by the group engagement partner often takes place during the course of the group audit, including the review of relevant component auditor audit documentation (also see paragraph A145).

*Communications with Component Auditors* (Ref: Para. 29)

A75. Clear and timely communication between the group auditor and the component auditors about their

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<sup>69</sup> Paragraphs 31 and A92-A93 of proposed QM SAS

respective responsibilities, along with clear direction to the component auditors about the nature, timing, and extent of the work to be performed and the matters expected to be communicated to the group auditor, helps establish the basis for effective two-way communication. Effective two-way communication between the group auditor and the component auditors also helps to set expectations for component auditors and facilitates the group auditor's direction and supervision of them and the review of their work. Such communication also provides an opportunity for the group engagement partner to reinforce the need for component auditors to exercise professional skepticism in the work performed for purposes of the group audit.

A76. Other factors that may also contribute to effective two-way communication include:

- Clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies or procedures of the group auditor's firm.
- A mutual understanding that the component auditor may discuss the audit work requested to be performed, based on the component auditor's knowledge and understanding of the component.
- A mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form of communications. For example, matters that need timely attention may be more appropriately discussed in a meeting rather than by exchanging emails.
- A mutual understanding of the person(s) from the group auditor and component auditors who have responsibility for managing communications regarding particular matters.
- The process for the component auditor to take action and report back on matters communicated by the group auditor.

A77. The communications between the group auditor and component auditors depend on the facts and circumstances of the group audit engagement, including the nature and extent of involvement of the component auditors and the degree to which the group auditor and component auditors are subject to common systems of quality management or common network requirements or network services.

Form of communications

A78. The form of the communications between the group auditor and component auditors may vary based on factors such as the nature of the audit work the component auditors have been requested to perform, and the extent to which communication capabilities are integrated into the audit tools used for the group audit.

A79. The form of communications also may be affected by such factors as:

- The significance, complexity, or urgency of the matter.
- Whether the matter has been or is expected to be communicated to group management and those charged with governance of the group.
- Whether the group auditor and component auditor are from the same firm or network firms.

A80. Communication between the group auditor and the component auditor may not necessarily be in writing. However, the group auditor's verbal communications with the component auditors may be

supplemented by written communication, such as a set of instructions regarding the work to be performed, when the group auditor wants to give particular attention to, or promote a mutual understanding about, certain matters. In addition, the group auditor may meet with the component auditor to discuss significant matters or to review relevant parts of the component auditor’s audit documentation.

- A81. Paragraph 45 requires the group auditor to request the component auditor to communicate matters relevant to the group auditor’s conclusion with regard to the group audit. As explained in paragraph A144, the form and content of the component auditor’s deliverables are influenced by the nature and extent of the audit work the component auditor has been requested to perform.
- A82. Regardless of the form of communication, the documentation requirements of this proposed SAS and other AU-C sections apply.

Timing of communications

- A83. The appropriate timing of communications will vary with the circumstances of the engagement. Relevant circumstances may include the nature, timing, and extent of work to be performed by the component auditor and the action expected to be taken by the component auditor. For example, communications regarding planning matters may often be made early in the audit engagement and, for an initial group audit, may be made as part of agreeing the terms of the engagement.

Non-compliance with laws or regulations (Ref: Para. 25, 29)

- A84. In applying AU-C section 250,<sup>70</sup> the group engagement partner may become aware of information about non-compliance or suspected non-compliance with laws or regulations. In such circumstances, the group engagement partner may have an obligation under relevant ethical requirements, laws or regulations, to communicate the matter to the component auditor or referred-to auditor.<sup>71</sup> The obligation of the group engagement partner to communicate non-compliance or suspected non-compliance may extend to auditors of the financial statements of entities or business units for which an audit is required by law or regulation or performed for another reason, but for which no audit work is performed for purposes of the group audit.

**Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group’s System of Internal Control (Ref: Para. 30)**

- A85. AU-C section 315<sup>72</sup> contains requirements and guidance regarding the auditor’s responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control. Appendix 2 of this proposed SAS provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how AU-C section 315 is to be applied to an audit of group financial statements.

- A85.1. The group auditor’s understanding of the group and its environment, the applicable financial reporting framework and the group’s system of internal controls with respect to the components for which a referred-to auditor performs an audit may vary as compared to the components for which a

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<sup>70</sup> AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

<sup>71</sup> See, for example, paragraphs 22–23 of the proposed “Responding to Noncompliance With Laws and Regulations” interpretation of the AICPA Code of Professional Conduct

<sup>72</sup> Paragraphs 19–31 and A58–A212 of AU-C section 315

component auditor performs audit procedures.

A86. The understanding of the group and its environment, the applicable financial reporting framework, and the group’s system of internal control may be obtained through communications with:

- Group management, component management or other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) and individuals who have knowledge of the group’s system of internal control, accounting policies and practices, and the consolidation process;
- Component auditors or referred-to auditors; or
- Auditors that perform an audit for legal, regulatory, or other reasons of the financial statements of an entity or business unit that is part of the group.

A87. Obtaining an understanding of the group, identifying risks of material misstatement, and assessing inherent risk and control risk may be performed in different ways depending on preferred audit techniques or methodologies and may be expressed in different ways. Accordingly, when component auditors are involved in the design and performance of risk assessment procedures, the group auditor may need to communicate its preferred approach with component auditors or provide instructions.

*Engagement Team Discussion* (Ref: Para. 30)

A88. In applying AU-C section 315,<sup>73</sup> the group engagement partner and other key engagement team members are required to discuss the application of the applicable financial reporting framework and the susceptibility of the group’s financial statements to material misstatement. The group engagement partner’s determination of which members of the engagement team to include in the discussion and the topics to be discussed, is affected by matters such as initial expectations about the risks of material misstatement and the preliminary expectation of whether to involve component auditors.

A89. The discussion provides an opportunity to:

- Share knowledge of the components and their environments, including which components’ activities are centralized.
- Exchange information about the business risks of the components or the group, and how inherent risk factors may affect susceptibility to misstatement of classes of transactions, account balances and disclosures.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. AU-C section 240<sup>74</sup> requires the engagement team discussion to place particular emphasis on how and where the entity’s financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.
- Identify policies followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting.
- Consider known external and internal factors affecting the group that may create an incentive

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<sup>73</sup> Paragraph 17 of AU-C section 315

<sup>74</sup> Paragraph 16 of AU-C section 240

or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.

- Consider the risk that group or component management may override controls.
- Discuss fraud that has been identified, or information that indicates existence of a fraud.
- Identify risks of material misstatement relevant to components where there may be impediments to the exercise of professional skepticism.
- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).
- Share information about risks of material misstatement of the financial information of a component that may apply more broadly to some, or all, of the other components.
- Share information that may indicate non-compliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices.
- Discuss events or conditions identified by group management, component management or the engagement team, that may cast significant doubt on the group's ability to continue as a going concern.
- Discuss related party relationships or transactions identified by group management or component management, and any other related parties of which the engagement team is aware.

*The Group and Its Environment* (Ref: Para. 30 (a))

A90. An understanding of the group's organizational structure and its business model may enable the group auditor to understand such matters as:

- The complexity of the group's structure. A group may be more complex than a single entity because a group may have several subsidiaries, divisions, or other business units, including in multiple locations. Also, a group's legal structure may be different from the operating structure, for example, for tax purposes. Complex structures often introduce factors that may give rise to increased susceptibility to material misstatements, such as whether goodwill, joint ventures or special purpose entities are accounted for appropriately and whether adequate disclosures have been made.
- The geographic locations of the group's operations. Having a group that is located in multiple geographical locations may give rise to increased susceptibility to material misstatements. For example, different geographical locations may involve different languages, cultures, and business practices.
- The structure and complexity of the group's IT environment. A complex IT environment often introduces factors that may give rise to increased susceptibility to material misstatements. For example, a group may have a complex IT environment because of multiple IT systems that are not integrated due to recent acquisitions or mergers. Therefore, it may be particularly important

to obtain an understanding of the complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment. A group may also use one or more external service providers for aspects of its IT environment.

- Relevant regulatory factors, including the regulatory environment. Different laws or regulations may introduce factors that may give rise to increased susceptibility to material misstatements. A group may have operations that are subject to a high degree of complex laws or regulations in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.
- The ownership, and relationships between owners and other people or entities, including related parties. Understanding the ownership and relationships can be more complex in a group that operates across multiple jurisdictions and when there are changes in ownership through formation, acquisition, disposal, or joint venture. These factors may give rise to increased susceptibility to material misstatements.

A91. Obtaining an understanding of the degree to which the group’s operations or activities are similar may help to identify similar risks of material misstatement across components and design an appropriate response.

A92. The financial results of entities or business units are ordinarily measured and reviewed by group management. Inquiries of group management may reveal that group management relies on certain key indicators to evaluate the financial performance of the group’s entities and business units and take action. The understanding of such performance measures may help to identify:

- Areas where there is increased susceptibility to material misstatements (e.g., due to pressures on component management to meet certain performance measures).
- Controls over the group’s financial reporting process.

*The Group’s System of Internal Control*

The Nature and Extent of Commonality of Controls (Ref: Para. 30(c)(i))

A93. Group management may design controls that are intended to operate in a common manner across multiple entities or business units (i.e., common controls). For example, group management may design common controls for inventory management, which operate using the same IT system and that are implemented across all entities or business units in the group. Common controls may exist in each component of the group’s system of internal control, and they may be implemented at different levels within the group (e.g., at the level of the consolidated group as a whole, or for other levels of aggregation within the group). Common controls may be direct controls or indirect controls. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that support direct controls.<sup>75</sup>

A94. Understanding the components of the group’s system of internal control includes understanding the commonality of tasks and actions, structures, processes, or controls within those components across the group.

In understanding the commonality of a control across the group, considerations that may be relevant include whether:

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<sup>75</sup> Paragraph A5 of AU-C section 315

- The control is designed centrally and is required to be implemented as designed (i.e., without modification) at some or all components;
- The control is implemented and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components where the control is implemented;
- If a control uses information from IT applications, the IT applications and other aspects of the IT environment that generate the information are the same across the components or locations; or
- If the control is automated, it is configured in the same way in each IT application across the components.

A96. Judgment may often be needed to determine whether a control is a common control. For example, group management may require that all entities and business units perform a monthly evaluation of the aging of customers' accounts that are generated from a specific IT application. When the aging reports are generated from different IT applications or the implementation of the IT application differs across entities or business units, there may be a need to consider whether the control can be determined to be common. This is because of differences in the design of the control that may exist due to the existence of different IT applications (e.g., whether the IT application is configured in the same manner across components, and whether there are effective general IT controls across different IT applications).

A97. Consideration of the level at which controls are performed within the group (e.g., at the level of the consolidated group as a whole or for other levels of aggregation within the group) and the degree of centralization and commonality may be important to the understanding of how information is processed and controlled. In some circumstances, controls may be performed centrally (e.g., performed only at a single entity or business unit), but may have a pervasive effect on other entities or business units (e.g., a shared service center that processes transactions on behalf of other entities or business units within the group). The processing of transactions and related controls at a shared service center may operate in the same way for those transactions being processed by the shared service center regardless of the entity or business unit (e.g., the processes, risks and controls may be the same regardless of the source of the transaction). In such cases, it may be appropriate to identify the controls and evaluate the design and determine the implementation of the controls, and, if applicable, test operating effectiveness, as a single population.

Centralized Activities (Ref: Para. 30(c)(i)–(ii))

A98. Group management may centralize some of its activities, for example financial reporting or accounting functions may be performed for a particular group of common transactions or other financial information in a consistent and centralized manner for multiple entities or business units (e.g., when the initiation, authorization, recording, processing, or reporting of revenue transactions is performed at a shared service center).

A99. Obtaining an understanding of how centralized activities fit into the overall group structure, and the nature of the activities undertaken, may help to identify and assess risks of material misstatement and appropriately respond to such risks. For example, controls at a shared service center may operate independently from other controls, or they may be dependent upon controls at an entity or business unit from which financial information is derived (e.g., sales transactions may be initiated and authorized at an entity or business unit, but the processing may occur at the shared service center).

A100. The group auditor may involve component auditors in testing the operating effectiveness of common controls or controls related to centralized activities. In such circumstances, effective collaboration

between the group auditor and component auditors is important as the audit evidence obtained through testing the operating effectiveness of common controls or controls related to centralized activities supports the determination of the nature, timing, and extent of substantive procedures to be performed across the group.

**Communications About Significant Matters that Support the Preparation of the Group Financial Statements (Ref: Para. 30(c)(iv))**

A101. Group entities or business units may use a financial reporting framework for legal, regulatory, or other reasons that is different from the financial reporting framework used for the group's financial statements. In such circumstances, an understanding of group management's financial reporting processes to align accounting policies and, when relevant, financial reporting period-ends that differ from that of the group, enables the group auditor to understand how adjustments, reconciliations and reclassifications are made, and whether they are made centrally by group management or by the entity or business unit.

**Instructions by group management to entities or business units**

A102. In applying AU-C section 315,<sup>76</sup> the group auditor is required to understand how group management communicates significant matters that support the preparation of the group financial statements. To achieve uniformity and comparability of financial information, group management may issue instructions (e.g., communicate financial reporting policies) to the entities or business units that include details about financial reporting processes or may have policies that are common across the group. Obtaining an understanding of group management's instructions may affect the identification and assessment of the risks of material misstatement of the group financial statements. For example, inadequate instructions may increase the likelihood of misstatements due to the risk that transactions are incorrectly recorded or processed, or that accounting policies are incorrectly or inconsistently applied.

A103. The group auditor's understanding of the instructions or policies may include the following:

- The clarity and practicality of the instructions for completing the reporting package.
- Whether the instructions:
  - Adequately describe the characteristics of the applicable financial reporting framework and the accounting policies to be applied;
  - Address information necessary to prepare disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example, disclosure of related party relationships and transactions, and segment information;
  - Address information necessary for making consolidation adjustments, for example, intra-group transactions and unrealized profits, and intra-group account balances; and
  - Include a reporting timetable.

**Considerations When Component Auditors Are Involved (Ref: Para. 31–32, 41)**

A104. During the course of the group audit, the group auditor may communicate the matters in paragraph 31 to other component auditors, if these matters are relevant to the work of those component auditors. Paragraph A142 includes examples of other matters that may need to be communicated timely in the course of the component auditor's work.

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<sup>76</sup> Paragraph 25(b) of AU-C section 315

A105. The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.<sup>77</sup> In a group audit there may be a higher risk of material misstatement of the group financial statements, including due to fraud, associated with related party relationships when:

- The group structure is complex;
- The group's information systems are not integrated and therefore less effective in identifying and recording related party relationships and transactions; and
- There are numerous or frequent related party transactions between entities and business units.

Planning and performing the audit with professional skepticism, as required by AU-C section 200,<sup>78</sup> is therefore particularly important when these circumstances exist.

**Identifying and Assessing the Risks of Material Misstatement (Ref: Para. 34)**

A106. The process to identify and assess the risks of material misstatement of the group financial statements is iterative and dynamic, and may be challenging, particularly when the component's activities are complex or specialized, or when there are many components across multiple locations. In applying AU-C section 315,<sup>79</sup> the auditor develops initial expectations about the potential risks of material misstatement and an initial identification of the significant classes of transactions, account balances and disclosures of the group financial statements based on their understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control.

A107. The initial expectations about the potential risks of material misstatement take into account the auditor's understanding of the group, including its entities or business units, and the environments and industries in which they operate. Based on the initial expectations, the group auditor may, and often will, involve component auditors in risk assessment procedures as they may have direct knowledge and experience with the entities or business units that may be helpful in understanding the activities and related risks, and where risks of material misstatement of the group financial statements may arise in relation to those entities or business units.

A108. For identified risks of material misstatement at the assertion level, the group auditor is required to take responsibility for assessing inherent risk. Such assessment involves assessing the likelihood and magnitude of misstatement, which takes into account how, and the degree to which:<sup>80</sup>

- Inherent risk factors affect the susceptibility of relevant assertions to misstatement.
- The risks of material misstatement at the group financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.

A109. Based on the risk assessment procedures performed, the group auditor may determine that an assessed risk of material misstatement of the group financial statements only arises in relation to financial information of certain components. For example, the risk of material misstatement relating to a legal claim may only exist in entities or business units that operate in a certain jurisdiction or in

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<sup>77</sup> Paragraph 3 of AU-C section 550

<sup>78</sup> Paragraph 18 of AU-C section 200

<sup>79</sup> Paragraph A143 of AU-C section 315

<sup>80</sup> Paragraph 35 of AU-C section 315

entities or business units that have similar operations or activities.

A110. Appendix 3 sets out examples of events and conditions that, individually or together, may indicate risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process.

*Fraud*

A111. In applying AU-C section 240,<sup>81</sup> the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risk that the group financial statements may be materially misstated due to fraud.
- Group management's process for identifying and responding to the risks of fraud in the group financial statements, including any specific fraud risks identified by group management, or classes of transactions, account balances, or disclosures for which a risk of fraud is higher.
- Whether there are particular components which are more susceptible to risks of material misstatement due to fraud.
- Whether any fraud risk factors or indicators of management bias exist in the consolidation process.
- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and when appropriate, component management, the component auditors, and others) to the group auditor's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.

*Considerations When Component Auditors Are Involved (Ref: Para. 34)*

A112. When the group auditor involves component auditors in the design and performance of risk assessment procedures, the group auditor remains responsible for having an understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control to have a sufficient basis for the identification and assessment of the risks of material misstatement of the group financial statements in accordance with paragraph 33.

A113. When the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement, AU-C section 315<sup>82</sup> requires the auditor to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

**Materiality**

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<sup>81</sup> Paragraphs 26 and 31 of AU-C section 240

<sup>82</sup> Paragraph 39 of AU-C section 315

*Component Performance Materiality* (Ref: Para. 35(a))

A114. Paragraph 35(a) requires the group auditor to determine component performance materiality for each of the components where the group auditor or component auditor will perform audit procedures on financial information that is disaggregated. The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.

A114.1 This proposed SAS does not require component performance materiality to be determined for components that are audited by referred-to auditors and for which the group auditor plans to make reference to in the auditor's report on the group financial statements.

A115. This proposed SAS does not require component performance materiality to be determined for each class of transactions, account balance or disclosure for components at which audit procedures are performed. However, if, in the specific circumstances of the group, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, AU-C section 320<sup>83</sup> requires a determination of the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. In these circumstances, the group auditor may need to consider whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate for those particular classes of transactions, account balances or disclosures.<sup>84</sup>

A116. The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the group auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (e.g., as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (e.g., if a single component represents a large portion of the group, there likely may be less disaggregation across components).
- Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example:
  - Whether there are risks that are unique to the financial information of the component (e.g., industry-specific accounting matters, unusual or complex transactions).
  - The nature and extent of misstatements identified at the component in prior audits.

A117. To address aggregation risk, paragraph 35(a) requires component performance materiality to be lower than group performance materiality. As explained in paragraph A116, as the extent of disaggregation across components increases, a lower component performance materiality amount ordinarily would be appropriate to address aggregation risk. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality

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<sup>83</sup> Paragraphs 10 and A14-A15 of AU-C section 320

<sup>84</sup> Paragraph A17 of AU-C section 320

because there is less aggregation risk, such as when the financial information for one component represents a substantial portion of the group financial statements. When determining component performance materiality for a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may take into account the group’s ownership percentage and the share of the investee’s profits and losses.

A118. In some cases, further audit procedures may be performed by the group auditor or a component auditor on a significant class of transactions or significant account balance as a single population (i.e., not disaggregated across components). In such cases, group performance materiality often will be used for purposes of performing these procedures.

A118.1 When the component is subject to an audit required by law or regulation or performed for another reason, the performance materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group performance materiality and, accordingly, be acceptable for purposes of the group audit.

*‘Clearly Trivial’ Threshold (Ref: Para: 35(b))*

A119. The threshold for communicating misstatements to the group auditor is set at an amount equal to, or lower than, the amount regarded as clearly trivial for the group financial statements. In accordance with AU-C section 450,<sup>85</sup> this threshold is the amount below which misstatements would not need to be accumulated because the group auditor expects that the accumulation of such amounts clearly would not have a material effect on the group financial statements.

*Considerations When Component Auditors Are Involved*

**Communicating Component Performance Materiality (Ref: Para. 36)**

A120. In some cases, it may be appropriate for the group auditor to involve the component auditor in determining an appropriate component performance materiality amount, in view of the component auditor’s knowledge of the component and potential sources of misstatement of the component financial information. In this regard, the group auditor also may consider communicating group performance materiality to the component auditor to support collaboration in determining whether component performance materiality, in relation to group performance materiality, is appropriate in the circumstances.

A121. Component performance materiality is based, at least in part, on expectations about the nature, frequency, and magnitude of misstatements in the component financial information. Therefore, ongoing communication between the component auditor and the group auditor is important, particularly if the number and magnitude of misstatements identified by the component auditor are higher than expected.

**Responding to the Assessed Risks of Material Misstatement (Ref: Para. 37)**

*Performing Further Audit Procedures*

**Performing Further Audit Procedures Centrally**

A122. Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally (e.g., at a shared service center). Factors that may be relevant to the

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<sup>85</sup> Paragraph A6 of AU-C section 450

auditor’s determination of whether to perform further audit procedures centrally include, for example:

- The level of centralization of activities relevant to financial reporting.
- The nature and extent of commonality of controls.
- The similarity of the group’s activities and business lines.

A123. The group auditor may determine that the financial information of several components can be considered as one population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogenous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way.

A124. When further audit procedures are performed centrally, component auditors may still be involved. For example, when the group has multiple shared service centers, the group auditor may involve component auditors in the performance of further audit procedures for these shared service centers.

**Performing Further Audit Procedures at the Component Level**

A125. In other circumstances, procedures to respond to the risks of material misstatement of the group financial statements that are related to the financial information of a component may be more effectively performed at the component level. This may be the case when the group has:

- Different revenue streams;
- Multiple lines of business;
- Operations across multiple locations; or
- Decentralized systems of internal control.

**Large Number of Components Whose Financial Information Is Individually Immaterial but Material in the Aggregate to the Group Financial Statements**

A126.A group may be comprised of a large number of components whose financial information is individually immaterial but material in the aggregate to the group financial statements. Circumstances such as these in which the significant classes of transactions, account balances or disclosures in the group financial statements are disaggregated over a large number of components may present additional challenges for the group auditor in planning and performing further audit procedures.

A127. In some cases, it may be possible to obtain sufficient appropriate audit evidence by performing further audit procedures centrally on these significant classes of transactions, account balances or disclosures (e.g., if they are homogeneous, subject to common controls and access to appropriate information can be obtained). The further audit procedures may also include substantive analytical procedures in accordance with AU-C section 520.<sup>86</sup> Depending on the circumstances of the engagement, the financial information of the components may be aggregated at appropriate levels for purposes of developing expectations and determining the amount of any difference of recorded amounts from expected values in performing the substantive analytical procedures. The use of automated tools and techniques may be helpful in these circumstances.

A128. In other cases, it may be necessary to perform further audit procedures at selected components to address the risks of material misstatement of the group financial statements. The determination of

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<sup>86</sup> AU-C section 520, *Analytical Procedures*

the components at which audit procedures are to be performed, and the nature, timing, and extent of further audit procedures to be performed at the selected components, are matters of professional judgment. In these circumstances, introducing an element of unpredictability in the components selected for testing also may be helpful in relation to the risks of material misstatement of the group financial statements due to fraud (also see paragraph A134).

*The Nature and Extent of Further Audit Procedures*

A129. In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):

- Design and perform further audit procedures on the entire financial information of the component;
- Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures; or
- Perform specific further audit procedures.

A130. Although the group auditor takes responsibility for the nature, timing, and extent of further audit procedures to be performed, component auditors can be, and often are, involved in all phases of the group audit, including in the design and performance of further audit procedures.

A130.1. The group auditor may determine that obtaining the audit report of a referred-to auditor with respect to one or more components may be appropriate audit evidence. In that case, the group auditor makes reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.

*Design and Perform Further Audit Procedures on the Entire Financial Information of the Component*

A131. The group auditor may determine that designing and performing further audit procedures on the entire financial information of a component is an appropriate approach, including when:

- Audit evidence needs to be obtained on all or a significant proportion of a component's financial information to respond to the assessed risks of material misstatement of the group financial statements.
- There is a pervasive risk of material misstatement of the group financial statements due to the existence of events or conditions at the component that may be relevant to the group auditor's evaluation of group management's assessment of the group's ability to continue as a going concern.

*Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures*

A132. The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but holds a significant portion of the land and buildings of the group or has significant tax balances.

*Perform specific further audit procedures*

A133. The group auditor may determine that designing and performing specific further audit procedures on

the financial information of a component is an appropriate approach, such as when audit evidence needs to be obtained for one or more relevant assertions only. For example, the group auditor may centrally test the class of transaction, account balance or disclosure and may require the component auditor to perform specific further audit procedures at the component (e.g., specific further audit procedures related to the valuation of claims or litigations in the component’s jurisdiction or the existence of an asset).

*Element of Unpredictability*

A134. Incorporating an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed and the extent to which the group auditor is involved in the work, may increase the likelihood of identifying a material misstatement of the components’ financial information that may give rise to a material misstatement of the group financial statements due to fraud.<sup>87</sup>

*Operating Effectiveness of Controls*

A135. The group auditor may rely on the operating effectiveness of controls that operate throughout the group in determining the nature, timing, and extent of substantive procedures to be performed at either the group level or at the components. AU-C section 330<sup>88</sup> requires the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of those controls. Component auditors may be involved in designing and performing such tests of controls.

A136. If deviations from controls upon which the auditor intends to rely are detected, AU-C section 330<sup>89</sup> requires the auditor to make specific inquiries to understand these matters and their potential consequences. If more deviations than expected are detected as a result of testing the operating effectiveness of the controls, the group auditor may need to revise the group audit plan. Possible revisions to the group audit plan may include:

- Performing additional substantive procedures at certain components.
- Identifying and testing the operating effectiveness of other relevant controls that are designed and implemented effectively.
- Increasing the number of components selected for further audit procedures.

A137. When the operating effectiveness of controls is tested centrally (e.g., controls at a shared service center or testing of common controls), the group auditor may need to communicate information about the audit work performed to the component auditors. For example, when a component auditor is requested to design and perform substantive procedures on the entire financial information of the component, or design and perform substantive procedures on one or more classes of transactions, account balances or disclosures, the component auditor may discuss with the group auditor about the control testing performed centrally to determine the nature, timing, and extent of the substantive procedures.

*Consolidation Process*

Consolidation Procedures (Ref: Para. 38(a))

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<sup>87</sup> Paragraph 29c of AU-C section 240

<sup>88</sup> Paragraph 8 of AU-C section 330

<sup>89</sup> Paragraph 17 of AU-C section 330

A138. The further audit procedures on the consolidation, including sub-consolidations, may include:

- Determining that the necessary journal entries are reflected in the consolidation; and
- Evaluating the operating effectiveness of the controls over the consolidation process and responding appropriately if any controls are determined to be ineffective.

*Consolidation Adjustments and Reclassifications (Ref: Para. 38(c))*

A139. The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements that do not pass through the usual IT applications, and may not be subject to the same controls to which other financial information is subject. The group auditor's evaluation of the appropriateness, completeness and accuracy of the adjustments and reclassifications may include:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;
- Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included;
- Determining whether significant adjustments have been correctly calculated, processed and authorized by group management and, when applicable, by component management;
- Determining whether significant adjustments are properly supported and sufficiently documented; and
- Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits or losses, and intra-group account balances.

*Considerations When Component Auditors Are Involved (Ref: Para. 42–43)*

A140. When the group auditor involves component auditors in the design or performance of further audit procedures, the component auditor may determine that the use of the work of an auditor's specialist is appropriate and communicate this to the group auditor. In such circumstances, when determining whether the component auditor's design and performance of further audit procedures is appropriate, the group auditor may, for example, discuss with the component auditor:

- The nature, scope, and objectives of the auditor's specialist's work.
- The component auditor's evaluation of the adequacy of the work of the auditor's specialist for the group auditor's purposes.

A141. The appropriate level of the group auditor's involvement may depend on the circumstances and the structure of the group and other factors, such as the group auditor's previous experience with the component auditors that perform procedures on the consolidation and sub-consolidations and the circumstances of the group audit engagement (e.g., if the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements).

**Evaluating the Component Auditor's Communication and the Adequacy of Their Work**

*Communication about Matters Relevant to the Group Auditor's Conclusion with Regard to the Group Audit (Ref: Para. 45)*

A142. Although the matters required to be communicated in accordance with paragraph 45 are relevant to the group auditor's conclusion with regard to the group audit, certain matters may be communicated

during the course of the component auditor’s procedures. In addition to the matters in paragraphs 32 and 50, such matters may include, for example:

- Information about breaches of relevant ethical requirements, including identified breaches of independence provisions;
- Information about instances of non-compliance with laws or regulations;
- Newly arising significant risks of material misstatement, including risks of fraud;
- Identified or suspected fraud or illegal acts involving component management or employees that could have a material effect on the group financial statements; or
- Significant and unusual transactions.

*Communication of Misstatements of Component Financial Information* (Ref: Para. 45(e))

A143. Knowledge about corrected and uncorrected misstatements across components may alert the group auditor to potential pervasive internal control deficiencies, when considered along with the communication of deficiencies in accordance with paragraph 45(g). In addition, a higher-than-expected number of identified misstatements (uncorrected or corrected) may indicate a higher risk of undetected misstatements, which may lead the group auditor to conclude that additional audit procedures need to be performed at certain components.

*Component Auditor’s Overall Findings or Conclusions* (Ref: Para. 45(k))

A144. The form and content of the deliverables from the component auditor are influenced by the nature and extent of the audit work the component auditor has been requested to perform. The group auditor’s firm policies or procedures may address the form or specific wording of an overall conclusion from the component auditor on the audit work performed for purposes of the group audit. In some cases, local law or regulation may specify the form of conclusion (e.g., an opinion) to be provided by the component auditor.

*Evaluating Whether Communications with the Component Auditor Are Adequate for the Group Auditor’s Purposes* (Ref: Para. 46(b))

A144A. If the group auditor determines that the component auditor’s communications are not adequate for the group auditor’s purposes, the group auditor may consider whether, for example:

- Further information can be obtained from the component auditor (e.g., through further discussions or meetings);
- It is necessary to review additional component auditor audit documentation in accordance with paragraph 47;
- Additional audit procedures may need to be performed in accordance with paragraph 48;
- There are any concerns about the component auditor’s competence or capabilities.

*Reviewing Additional Component Auditor Audit Documentation* (Ref: Para. 47)

A145. Paragraph A72 provides guidance for the group auditor in tailoring the nature, timing and extent of the direction and supervision of the component auditor, and the review of their work, based on the facts and circumstances of the group audit and other matters (e.g., the assessed risks of material misstatement of the group financial statements). The group auditor’s consideration in accordance with paragraph 47(c) also may be affected by the following matters relevant to the group auditor’s ongoing involvement in the work of the component auditor:

- Communications from the component auditor, including those in accordance with paragraph 45 of this proposed SAS; and
- The review of component auditor audit documentation by the group auditor during the course of the group audit (e.g., to fulfill the requirements of paragraphs 34, 42 and 43) or by the group engagement partner in accordance with paragraph 31 of proposed QM SAS .

A146. Other factors that may affect the group auditor’s determination about whether, and the extent to which, it is necessary to review additional component auditor audit documentation in the circumstances include:

- The degree to which the component auditor was involved in risk assessment procedures and in the identification and assessment of the risks of material misstatement of the group financial statements;
- The significant judgments made by, and the findings or conclusions of, the component auditor about matters that are material to the group financial statements;
- The competence and capabilities of more experienced engagement team members from the component auditor responsible for reviewing the work of less experienced individuals; and
- Whether the component auditor and group auditor are subject to common policies or procedures for review of audit documentation.

**Subsequent Events** (Ref: Para. 49–50)

A147. When component auditors are involved, the group auditor may:

- Request a component auditor to perform subsequent events procedures to assist the group auditor to identify events that occur between the dates of the financial information of the components and the date of the auditor’s report on the group financial statements.
- Perform procedures to cover the period between the date of communication of subsequent events by the component auditor and the date of the auditor’s report on the group financial statements.

**Making Reference to the Audit of a Referred-to Auditor in the Auditor’s Report on the Group Financial Statements**

*Understanding the Referred-to Auditor*

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors (Ref: Para. 50.1)

A147.2 When the group engagement partner determines to make reference, the referred-to auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit. Such requirements may be different or in addition to those applying to a referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the referred-to auditor’s jurisdiction. When the referred-to auditor is not subject to the *AICPA Code of Professional Conduct*, compliance by the referred-to 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 referred-to auditor’s ethical responsibilities in the group audit.

Competence and Capabilities of Referred-To Auditors (Ref: Para. 50.2-50.3)

A147.3 Determining whether referred-to auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement.

A147.3.1 In determining whether referred-to auditors have the appropriate competence and capabilities, the group engagement partner may consider matters such as:

- Previous experience with or knowledge of the referred-to auditor.
- The referred-to auditor’s specialized skills (e.g., industry specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies).
- The referred-to auditor’s understanding of the auditing and other standards applicable to the group audit, such as GAAS that is sufficient to fulfill the referred-to auditor’s responsibilities.
- Whether a referred-to auditor operates in a regulatory environment that actively oversees auditors.

A147.3.2 The procedures to determine the referred-to auditor’s competency and capability may include, for example:

- Requesting the referred-to auditor to confirm the matters referred to in paragraph 50.2 in writing.
- Obtaining published external inspection reports, peer review reports on the component auditor’s firm and other relevant publicly available information relating to the professional reputation and standing of a referred-to auditor.

*Determining Whether to Make Reference (Ref: Para. 50.4-50.5)*

A147.4 In accordance with this proposed SAS, the group engagement partner determines, individually for each component, whether to

- a. be involved in the work of the component auditor, insofar as that work relates to the expression of an audit opinion on the group financial statements, or
- b. make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements.

A147.4.1 In group audits involving two or more potential referred-to auditors, the decision to make reference is made individually for each potential referred-to auditor. The group auditor may make reference to any, all, or none of the potential referred-to auditors. For example, if components are audited by an auditor from a network firm and one component is audited by another firm, the group engagement partner may decide to be involved in the work of the auditor from the network firm and to make reference to the work of the auditor from the other firm.

A147.4.2 Factors that may affect the group engagement partner’s determination of whether to make reference to the audit of a potential referred-to auditor in the auditor’s report on the group financial statements include the following:

- The group auditor’s understanding of the group and its environment and the group’s system of internal control
- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet

the group reporting timetable

- Differences in the auditing and other standards applied by the auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group auditor to be involved in the work of an auditor.

*Determining Whether the Audit Was Conducted in Accordance With GAAS* (Ref: Para. 50.5(a))

A147.5 An auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph 50.5(a). When the auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph 50.5(a), relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group auditor may provide the referred-to auditor with AU-C Appendix B, Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards, that identifies substantive requirements of GAAS that are not requirements in the ISAs. The referred-to auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the referred-to auditor required by [paragraph 50.9-50.10](#) may address whether the audit met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the referred-to auditor, may decide to make reference to the audit of that referred-to auditor in the auditor's report on the group financial statements.

*Determining Whether to Make Reference When the Financial Reporting Framework is Not the Same* (Ref: Para. 50.5.1)

A147.6. When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group auditor is required by this proposed SAS to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the group auditor is involved in the work of the auditor. In rare circumstances, however, the group engagement partner may conclude that the group auditor can reasonably expect to obtain 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 be involved in the work of the auditor.

A147.7. The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of all material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and *International Financial Reporting Standard for Small and Medium-sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as more similar to

financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in AU-C [section 800](#), *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP.

A147.8. Additional considerations in determining whether it may be appropriate to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements when the component prepares financial statements using a different financial reporting framework than that used by the group include the

- effectiveness of groupwide controls and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments.
- depth of the group auditor's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments.
- extent of the group auditor's knowledge of the financial reporting framework used to prepare the component financial statements.
- group auditor's ability to obtain information from group or component management that is relevant to the adjustments.
- need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments.

*Considerations for Governmental Entities*

A147.9. When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by the Governmental Accounting Standards Board and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs 50.5.1 and [50.6c](#) are not relevant.

*Making Reference (Ref: Par. 50.6-50.7)*

A147.10 Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor is not to be construed as a qualification of the opinion, but rather is intended to communicate (1) that the group auditor was not involved in the work of the referred-to auditor, and (2) the source of the audit evidence with respect to those components for which reference to the audit of referred-to auditors is made.

A147.11 The disclosure of the magnitude of the portion of the financial statements audited by a referred-to auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a referred-to auditor. When two or more referred-to auditors are referred to, the dollar amounts or the percentages covered by the referred-to auditors may be stated in the aggregate.

A147.12 Exhibit A contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a referred-to auditor.

*Modified Opinion in Referred to Auditor's Report* (Ref: par. 50.8)

A147.13 If the modified opinion, emphasis-of-matter paragraph, other-matter paragraph, or going concern section in the referred-to auditor's report does not affect the report on the group financial statements and the referred-to auditor's report is not presented, the group auditor need not make reference to those paragraphs or section in the auditor's report on the group financial statements. If the referred-to auditor's report is presented, the group auditor may make reference to those paragraphs or section and their disposition.

*Subsequent Events* (Ref: Para. 50.13)

A147.14. When the group engagement partner determines to make reference, procedures designed to identify subsequent events between the date of the referred-to auditor's report and the date of the auditor's report on the group financial statements may include:

- (a) Obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified.
- (b) Requesting the referred-to auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements.
- (c) Requesting written representation from component management regarding subsequent events.
- (d) Reading available interim financial information of the component and making inquiries of group management.
- (e) Reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date.
- (f) Reading the subsequent year's capital and operating budgets.
- (g) Inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events.
- (h) Considering the implications for the auditor's report on the group financial statements if the group auditor has been unable to obtain sufficient appropriate audit evidence regarding subsequent events.

**Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

*Sufficiency and Appropriateness of Audit Evidence* (Ref: Para. 51)

A148. The audit of group financial statements is a cumulative and iterative process. As the group auditor performs planned audit procedures, the audit evidence obtained may cause the group auditor to modify the nature, timing, or extent of other planned audit procedures as information may come to

the group auditor’s attention that differs significantly from the information on which the risk assessment was based. For example:

- The misstatements identified at a component may need to be considered in relation to other components; or
- The group auditor may become aware of access restrictions to information or people at a component because of changes in the environment (e.g., war, civil unrest, or outbreaks of disease).

In such circumstances, the group auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the significant classes of transactions, account balances, or disclosures and related assertions.

A149. The evaluation required by paragraph 51 assists the group auditor in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in AU-C section 330<sup>90</sup> for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material class of transactions, account balance, and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.

A150. The group auditor may consider the engagement team’s exercise of professional skepticism when evaluating the sufficiency and appropriateness of audit evidence obtained. For example, the group auditor may consider whether matters such as those described in paragraph A16 have inappropriately led the engagement team to:

- Obtain audit evidence that is easier to access without giving appropriate consideration to its relevance and reliability;
- Obtain less persuasive evidence than is necessary in the circumstances; or
- Design and perform audit procedures in a manner that is biased towards obtaining evidence that is corroborative or excluding evidence that is contradictory.

A151. Proposed QM SAS <sup>91</sup> requires the engagement partner to determine, on or before the date of the auditor’s report, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued. Information that may be relevant to the group auditor’s evaluation of the audit evidence obtained from the work performed by component auditors or referred-to auditors depends on the facts and circumstances of the group audit, and may include:

- The communications from the component auditors required by paragraph 45, including the overall findings or conclusions of the component auditors on the work performed for purposes of the group audit;
- Other communications from the component auditors throughout the group audit, including those required by paragraph 32; and

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<sup>90</sup> Paragraph 18 Of AU-C section 330

<sup>91</sup> Paragraph 32 of proposed QM SAS

- The group auditor’s direction and supervision of the component auditors, and review of their work, including, as applicable, the group auditor’s review of additional component auditor audit documentation in accordance with paragraph 47.
- The referred-to auditor’s report on the component’s financial statements, including, as applicable, if the opinion of a referred-to auditor is modified or if that report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section.
- The communications from the referred-to auditors required by this proposed SAS.

A152. In some circumstances, an overall summary memorandum describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.

*Evaluating the Effect on the Group Audit Opinion* (Ref: Para: 52)

A153. The group engagement partner’s evaluation may include a consideration of whether corrected and uncorrected misstatements communicated by component auditors indicate a systemic issue (e.g., regarding transactions subject to common accounting policies or common controls) that may affect other components.

**Communication with Group Management and Those Charged with Governance of the Group**

*Communication with Group Management* (Ref: Para. 54–56)

A156. The group audit may be complex due to the number and nature of the entities and business units comprising the group. In addition, as explained in paragraph A7, the group auditor may determine that certain entities or business units may be considered together as a component for purposes of planning and performing the group audit. Therefore, discussing with group management an overview of the planned scope and timing may help in coordinating the work performed at components, including when component auditors are involved or reference is made to referred-to auditors, and in identifying component management (see paragraph A22).

A157. AU-C section 240<sup>92</sup> contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.

A158. Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation.
- Plans for abandonment of material operating assets.
- Subsequent events.
- Significant legal agreements.

A159. Group management may inform the group auditor about non-compliance or suspected non-compliance with laws or regulations in entities or business units within the group. Paragraph A84

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<sup>92</sup> Paragraphs 40-42 of -AU-C section 240

provides guidance for the group engagement partner in these circumstances.

*Communication with Those Charged with Governance of the Group* (Ref: Para. 57)

A160. The matters the group auditor communicates to those charged with governance of the group may include those brought to the attention of the group auditor by component auditors or referred-to auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group may take place at various times during the group audit. For example, the matter referred to in paragraph 57(a) may be communicated after the group auditor has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph 57(b) may be communicated at the end of the audit, and the matters referred to in paragraph 57(c)–(d) may be communicated when they occur.

A161. AU-C section 260<sup>93</sup> requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. For a group audit, this communication helps those charged with governance understand the group auditor's determination of the components at which audit work will be performed, including whether certain of the group's entities or business units will be considered together as a component, and the planned involvement of component auditors. This communication also helps to enable a mutual understanding of and discussion about the group and its environment (see paragraph 30) and areas, if any, in which those charged with governance may request the group auditor to undertake additional procedures.

*Communication of Identified Deficiencies in Internal Control* (Ref: Para. 58)

A162. The group auditor is responsible for determining, on the basis of the audit work performed, whether one or more identified deficiencies, individually or in combination, constitute significant deficiencies or material weaknesses.<sup>94</sup> The group auditor may request input from the component auditor about whether an identified deficiency or combination of deficiencies at the component is a significant deficiency or material weakness in internal control.

**Documentation** (Ref: Para. 59)

A163. Other AU-C sections contain specific documentation requirements that are intended to clarify the application of AU-C section 230 in the particular circumstances of those other AU-C sections. The Appendix to AU-C section 230 lists other AU-C sections that contain specific documentation requirements and guidance.

A164. The audit documentation for the group audit supports the group auditor's evaluation in accordance with paragraph 51 as to whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion. Also see paragraph A151.

A165. The audit documentation for the group audit comprises:

- The documentation in the group auditor's file; and
- The separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit (i.e., component auditor audit documentation).

A166. The final assembly and retention of the audit documentation for a group audit is subject to the policies or procedures of the group auditor's firm in accordance with proposed SQMS 1.<sup>95</sup> The group auditor

<sup>93</sup> Paragraph 11 of AU-C section 260

<sup>94</sup> Paragraph 9 of AU-C section 265

<sup>95</sup> Paragraphs 32(f) and A87-A89 of proposed SQMS 1

may provide specific instructions to component auditors regarding the assembly and retention of the documentation of work performed by them for purposes of the group audit.

*Basis for the Group Auditor's Determination of Components* (Ref: Para: 59(b))

A167. The basis for the group auditor's determination of components and the basis for the decision to make reference to the audit of a referred-to auditor may be documented in various ways, including, for example, documentation related to the fulfillment of the requirements in paragraphs 22, 33 and 57(a) of this proposed SAS

*Basis for the Group Auditor's Determination of the Competence and Capabilities of Component Auditors* (Ref: Para: 59(d))

A168. Proposed SQMS 1<sup>96</sup> provides guidance on matters that the firm's policies or procedures may address regarding the competence and capabilities of the engagement team members. Such policies or procedures may describe or provide guidance about how to document the determination of the competence and capabilities of the engagement team, including component auditors. For example, the confirmation obtained from the component auditor in accordance with paragraph 24 may include information about the component auditor's relevant industry experience. The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures (see paragraph A59).

*Documentation of the Direction and Supervision of Component Auditors and the Review of Their Work* (Ref: Para. 59(f))

A169. As described in paragraph A72, the approach to direction, supervision and review in a group audit will be tailored by the group auditor based on the facts and circumstances of the engagement, and will generally include a combination of addressing the group auditor's firm policies or procedures and responses specific to the group audit. Such policies or procedures may also describe or provide guidance about the documentation of the group auditor's direction and supervision of the engagement team and the review of their work.

A170. AU-C section 300<sup>97</sup> requires the auditor to develop an audit plan that includes a description of the nature, timing and extent of the planned direction and supervision of engagement team members and the review of their work. When component auditors are involved, the extent of such descriptions will often vary by component, recognizing that the planned nature, timing and extent of direction and supervision of component auditors, and review of their work, may be influenced by the matters described in paragraph A48.

A171. The group auditor's documentation of the direction and supervision of component auditors and the review of their work may include, for example:

- Required communications with component auditors, including any instructions issued and other confirmations required by this proposed SAS.
- The rationale for the selection of visits to component auditor sites, attendees at meetings and the nature of the matters discussed.
- Matters discussed in meetings with component auditors or component management.
- The rationale for the group auditor's determination of component auditor audit documentation selected for review.

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<sup>96</sup> Paragraph A100 of proposed SQMS 1

<sup>97</sup> Paragraph 9 of AU-C section 300

- Changes in the planned nature and extent of involvement with component auditors, and the reasons why. This may include circumstances in which the group auditor modified the nature, timing or extent of the direction and supervision of the component auditors, and the review of their work, in areas of the audit that are more complex or subjective than initially anticipated.

A172. Paragraph 47 requires the group auditor to determine whether, and the extent to which it is necessary to review additional component auditor audit documentation. Paragraphs A145–A146 provide guidance for the group auditor in making this determination.

A173. Component auditor audit documentation ordinarily need not be replicated in the group auditor’s audit file. However, the group auditor may decide to summarize, replicate or retain copies of certain component auditor documentation in the group auditor’s audit file to supplement the description of a particular matter in communications from the component auditor, including the matters required to be communicated by this proposed SAS. Examples of such component auditor documentation may include:

- A listing or summary of the significant judgments made by the component auditor, and the conclusions reached thereon, that are relevant to the group audit;
- Matters that may need to be communicated to those charged with governance of the group; or
- Matters that may be determined to be key audit matters to be communicated in the auditor’s report on the group financial statements.

A174. When required by law or regulation, certain component auditor documentation may need to be included in the group auditor’s audit file, for example, to respond to the request of a regulatory authority to review documentation related to work performed by a component auditor.

A175. Policies or procedures established by the firm in accordance with the firm’s system of quality management, or resources provided by the firm or a network, may assist the group auditor in documenting the direction and supervision of component auditors and the review of their work. For example, an electronic audit tool may be used to facilitate communications between the group auditor and component auditors. The electronic audit tool also may be used for audit documentation, including providing information about the reviewer(s) and the date(s) and extent of their review.

*Additional Considerations When Access to Component Auditor Audit Documentation is Restricted* (Ref: Para. 59)

A176. Audit documentation for a group audit may present some additional complexities or challenges in certain circumstances. This may be the case, for example, when law or regulation restrict the component auditor from providing documentation outside of its jurisdiction, or when war, civil unrest or outbreaks of disease restrict access to relevant component auditor audit documentation.

A177. The group auditor may be able to overcome such restrictions by, for example:

- Visiting the location of the component auditor, or meeting with the component auditor in a location different from where the component auditor is located, to review the component auditor’s audit documentation;
- Reviewing the relevant audit documentation remotely through the use of technology, when not prohibited by law or regulation;
- Requesting the component auditor to prepare and provide a memorandum that addresses the

relevant information and holding discussions with the component auditor, if necessary, to discuss the contents of the memorandum; or

- Discussing with the component auditor the procedures performed, the evidence obtained and the conclusions reached by the component auditor.

It is a matter of professional judgment whether one or more of the actions described above may be sufficient to overcome the restrictions depending on the facts and circumstances of the group audit.

A178. When access to component auditor audit documentation is restricted, the group auditor's documentation nonetheless needs to comply with the requirements of GAAS, including those relating to the documentation of the nature, timing and extent of the group auditor's direction and supervision of component auditors and the review of their work. The guidance in paragraphs A145–A146 may be helpful in determining the extent of the group auditor's review of the component auditor audit documentation in these circumstances. Paragraphs A173 and A174 provide examples of circumstances in which certain component auditor audit documentation may be included in the group auditor's audit file.

A179. If the group auditor is unable to overcome restrictions on access to the component auditor audit documentation, the group auditor may need to consider whether a scope limitation exists that may require a modification to the opinion on the group financial statements. See paragraph A42.

## Appendix 1: Illustrative Auditor’s Reports on Group Financial Statements

(Ref: Para. A42)

### Illustration 1— Independent Auditor’s Report With a Qualified Opinion When the Group Auditor Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Auditor’s Opinion

Circumstances include the following

- Audit of a complete set of consolidated general purpose financial statements
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management’s responsibility for the consolidated financial statements in AU-C section 210 , *Terms of Engagement*.
- The group auditor is unable to obtain sufficient appropriate audit evidence relating to a component accounted for by the equity method because the group auditor was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor’s report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a referred-to auditor. In the auditor’s professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor’s report contains a qualified opinion
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events considered in the aggregate that raise substantial doubt about the entity’s ability to continue as a going concern.
- The auditor has not been engaged to communicate key audit matters in accordance with AU-C section 701.<sup>1</sup>
- The auditor has obtained all the other information prior to the date of the auditor’s report and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.

### Independent Auditor’s Report

[Appropriate Addressee]

#### Report on the Audit of the Consolidated Financial Statements<sup>2</sup>

##### **Qualified Opinion**

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of December 31, 20X1, and the related consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the related notes to the

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<sup>1</sup> AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

<sup>2</sup> The sub-title, “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title, “Report on Other Legal and Regulatory Requirements” is not applicable.

consolidated financial statements.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America .

***Basis for Qualified Opinion***

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$\_\_\_\_\_and \$\_\_at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$\_\_\_\_\_and \$\_\_, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures. A

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are required to be independent of ABC Company and its subsidiaries and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

***Responsibilities of Management<sup>3</sup>***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework*].

***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit

procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>4</sup>

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

*Other Information* [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

#### **Report on Other Legal and Regulatory Requirements**

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm [City and state where the auditor's report is issued]  
[Date of the auditor's report]

#### **Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards**

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in section 210, *Terms of Engagement*.
- The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).
- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.

- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

### **Independent Auditor's Report**

[Appropriate Addressee]

#### **Report on the Consolidated Financial Statements<sup>5</sup>**

##### ***Opinion***

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

##### ***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

##### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's

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<sup>5</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable

ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>6</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

*Other Information* [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

*[Reporting in accordance with the reporting requirements in section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]*

### **Report on Other Legal and Regulatory Requirements**

*[The form and content of this section of the auditor's report would vary depending on the nature of the*

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<sup>6</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable

*auditor's other reporting responsibilities.]*

*[Signature of auditor's firm]*

*[City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

**Illustration 3— A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS**

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.

**Independent Auditor's Report**

*[Appropriate Addressee]*

**Report on the Consolidated Financial Statements<sup>1</sup>**

***Opinion***

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Financial Statements section of our report. We are required to be

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<sup>1</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

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<sup>2</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable

### **Report on Other Legal and Regulatory Requirements**

*[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Signature of auditor's firm]*

*[City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

### **Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS**

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

### **Independent Auditor's Report**

*[Appropriate Addressee]*

### **Report on the Consolidated Financial Statements<sup>1</sup>**

#### ***Opinion***

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors

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<sup>1</sup> The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.

### ***Basis for Opinion***

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Responsibilities of Management for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

### ***Auditor's Responsibilities for the Audit of the Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.<sup>2</sup>
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

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<sup>2</sup> In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

**Report on Other Legal and Regulatory Requirements**

*[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]*

*[Signature of auditor's firm]*

*[City and state where the auditor's report is issued]*

*[Date of the auditor's report]*

## Appendix 2

(Ref: Para. A85)

### Understanding the Group’s System of Internal Control

1. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how AU-C section 315<sup>1</sup> is to be applied in relation to an audit of group financial statements. The examples may not be relevant to every group audit engagement and the list of examples is not necessarily complete.

#### Control Environment

2. The group auditor’s understanding of the control environment may include matters such as the following:
  - The structure of the governance and management functions across the group, and group management’s oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group.
  - How oversight over the group’s system of internal control by those charged with governance is structured and organized.
  - How ethical and behavioral standards are communicated and reinforced in practice across the group, (e.g., group-wide programs, such as codes of conduct and fraud prevention programs).
  - The consistency of policies and procedures across the group, including a group financial reporting procedures manual.

#### The Group’s Risk Assessment Process

3. The group auditor’s understanding of the group’s risk assessment process may include matters such as group management’s risk assessment process, that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group’s risk assessment process is and the involvement of entities and business units in this process.

#### The Group’s Process to Monitor the System of Internal Control

4. The group auditor’s understanding of the group’s process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, when relevant, activities of the internal audit function across the group. The group’s internal audit function, including its nature, responsibilities, and activities in respect of monitoring of controls at entities or business units in the group. ISA 610 (Revised 2013)<sup>2</sup> requires the auditor to evaluate the extent to which the internal audit function’s organizational status and relevant policies and procedures support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a systematic and disciplined approach, including quality control.

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<sup>1</sup> Appendix C of AU-C section 315

<sup>2</sup> AU-C section 610 , *Using the Work of Internal Auditors*, paragraph 15

**The Information System and Communication**

5. The group auditor’s understanding of the group’s information system and communication may include matters such as the following:
  - The extent of centralization in the group’s IT environment and the commonality of IT applications, IT processes and IT infrastructure.
  - Group management’s monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to monitor performance against budgets, and to take appropriate action.
  - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at group level.
  - A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group.

*Consolidation Process*

6. The group auditor’s understanding of the consolidation process may include matters such as the following:
  - Matters relating to the applicable financial reporting framework:
    - The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework.
    - The process for identifying and accounting for entities or business units in the group in accordance with the applicable financial reporting framework.
    - The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework.
    - The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework.
    - The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework.
    - The procedures for dealing with entities or business units in the group with financial year-ends different from the group’s year-end.

Matters relating to the consolidation process:

- Group management’s process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial statements, and that differences in accounting policies are identified, and adjusted when required in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the entities or business units in the group use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.
- Group management’s process for ensuring complete, accurate and timely financial

reporting by the entities or business units in the group for the consolidation.

- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial statements.
- How the group's IT environment is organized for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters relating to consolidation adjustments and reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorization and processing of related journal entries, and the experience of personnel responsible for the consolidation.
- The consolidation adjustments required by the applicable financial reporting framework.
- The business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature, and size of transactions between entities or business units in the group.
- The procedures for monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework.
- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (e.g., an obligation of the minority interest to make good such losses).

### **Control Activities**

7. The group auditor's understanding of the control activities component may include matters such as the following:
  - The commonality of information processing controls and general IT controls for all or part of the group.
  - The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial statements at the assertion level.
  - The extent to which commonly designed controls have been implemented consistently for all or part of the group.

**Appendix 3**  
(Ref: Para. A110)

**Examples of Events or Conditions that May Give Rise to Risks of Material Misstatement of the Group Financial Statements**

The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degree. Also see ISA 315 (Revised 2019), Appendix 2.

<b>Inherent Risk Factor</b>	<b>Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Statements at the Assertion Level:</b>
Complexity	<ul style="list-style-type: none"> <li>• The existence of complex transactions that are accounted for in more than one entity or business units in the group.</li> <li>• The application of accounting policies by entities or business units in the group that differ from those applied to the group financial statements.</li> <li>• Accounting measurements or disclosures that involve complex processes used by entities or business units in the group such as accounting for complex financial instruments.</li> <li>• Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation.</li> </ul>
Subjectivity	<ul style="list-style-type: none"> <li>• Judgments regarding which entities or business units in the group require incorporation of their financial information in the group financial statements in accordance with the applicable financial reporting framework, for example, whether any special-purpose entities or non-trading entities exist and require incorporation.</li> <li>• Judgments regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group.</li> </ul>
Change	<ul style="list-style-type: none"> <li>• Frequent acquisitions, disposals, or reorganizations.</li> </ul>
Uncertainty	<ul style="list-style-type: none"> <li>• Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade and fiscal policy, and restrictions on currency and dividend movements; and fluctuations in exchange rates.</li> </ul>

Susceptibility to Misstatement Due to Management Bias or Other Fraud Risk Factors Insofar as They Affect Inherent Risk	<ul style="list-style-type: none"> <li>• Unusual related party relationships and transactions.</li> <li>• Entities or business units in the group with different financial year-ends, which may be utilized to manipulate the timing of transactions.</li> <li>• Prior occurrences of unauthorized or incomplete consolidation adjustments.</li> <li>• Aggressive tax planning within the group, or large cash transactions with entities in tax havens.</li> <li>• Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.</li> <li>• Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk</li> </ul>
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Indicators that the control environment, the group’s risk assessment process or the group’s process to monitor the group’s system of internal control are not appropriate to the group’s circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group’s system of internal control, include:

- Poor corporate governance structures, including decision making processes that are not transparent.
- Non-existent or ineffective controls over the group’s financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group.

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 600  
(REVISED), SPECIAL CONSIDERATIONS—AUDITS OF GROUP  
FINANCIAL STATEMENTS (INCLUDING THE WORK OF  
COMPONENT AUDITORS)**

**(Marked from September 2021 Board meeting (Agenda Item 2-C))**

**Grey highlighted paragraphs were included in, and are marked from, the  
September 2021 turnaround draft (Agenda Item 2-F)**

## Introduction

### Scope of this ISA

1. The International Standards on Auditing (ISAs) apply to an audit of group financial statements (a group audit). This ISA deals with special considerations that apply to a group audit, including in those circumstances when component auditors are involved. The requirements and guidance in this ISA refer to, or expand on, the application of other relevant ISAs to a group audit, in particular ISA 220 (Revised),<sup>1</sup> ISA 230,<sup>2</sup> ISA 300,<sup>3</sup> ISA 315 (Revised 2019),<sup>4</sup> and ISA 330.<sup>5</sup> (Ref: Para. A1–A2)
- 24A.** Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph **914(k)**. The term consolidation process as used in this ISA refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions. (Ref: Para. **A32A–A52B, A2546A**)
- 34B.** As explained in ISA 220 (Revised),<sup>6</sup> this ISA, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this ISA may be useful when involving such an individual to attend a physical inventory count, inspect property, plant and equipment, or perform audit procedures at a shared service center at a remote location.

### Groups and Components

- 43.** A group may be organized in various ways. For example, a group may be organized by legal or other entities (e.g., a parent and one or more subsidiaries, joint ventures, or investments accounted for by the equity method). Alternatively, the group may be organized by geography, by other economic units (including branches or divisions), or by functions or business activities. In this ISA, these different forms of organization are collectively referred to as “entities or business units.” (Ref: Para. **A6A3A**)

<sup>1</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>2</sup> ISA 230, *Audit Documentation*

<sup>3</sup> ISA 300, *Planning an Audit of Financial Statements*

<sup>4</sup> ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

<sup>5</sup> ISA 330, *The Auditor's Responses to Assessed Risks*

<sup>6</sup> ISA 220 (Revised), paragraph A1

**53A.** The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, the group auditor uses professional judgment in determining the components at which audit work will be performed. This determination is based on the group auditor's understanding of the group and its environment, and other factors such as the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and internal control across the group. (Ref: Para. A7A5–A9A6A)

#### *Involvement of Component Auditors*

**63B.** ISA 220 (Revised)<sup>7</sup> requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner.<sup>8</sup> In a group audit, such resources may include component auditors. Therefore, this ISA requires the group auditor to determine the nature, timing and extent of involvement of component auditors.

**73C.** The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this ISA. Component auditors may have greater experience with, and a more in-depth knowledge of the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit. (Ref: Para. A10A8AA)

**84.** Audit risk is a function of the risks of material misstatement and detection risk.<sup>9</sup> Detection risk in a group audit includes the risk that the a component auditor may not detect a misstatement in the financial information of the a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this ISA requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this ISA explains the matters that the group auditor takes into account when determining the nature, timing and extent of the direction and supervision of component auditors and the review of their work. (Ref: Para. A11A8A–A12A8B)

#### *Professional Skepticism*

**95.** In accordance with ISA 200,<sup>10</sup> the engagement team is required to plan and perform the group audit with professional skepticism and to exercise professional judgment. The appropriate exercise of professional skepticism may be demonstrated through the actions and communications of the engagement team, including emphasizing the importance of each engagement team member exercising professional skepticism throughout the group audit. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate exercise of professional skepticism. (Ref: Para. A13A9–A17A10)

<sup>7</sup> ISA 220 (Revised), paragraph 25

<sup>8</sup> ISA 220 (Revised), paragraph 25

<sup>9</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A34

<sup>10</sup> ISA 200, paragraphs 15–16 and A20–A24

### Scalability

105A. This ISA is intended for all group audits, regardless of size or complexity. However, the requirements of this ISA are intended to be applied in the context of the nature and circumstances of each group audit. For example, when a group audit is carried out entirely by the group auditor, some requirements in this ISA are not relevant because they are conditional on the involvement of component auditors. This may be the case when the group auditor is able to perform audit procedures centrally or is able to perform procedures at the components without involving component auditors. The guidance in paragraphs A117A75A and A118A76 also may be helpful in applying this ISA in these circumstances.

### Responsibilities of the Group Engagement Partner and Group Auditor

116. The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this ISA. The term “the group engagement partner shall take responsibility for...” or “the group auditor shall 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 ISA 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. (Ref: Para. A27A19)

### Effective Date

127. This ISA is effective for audits of group financial statements for periods beginning on or after December 15, ~~20XX~~2023.

### Objectives

138. The objectives of the auditor are to:

- (a) With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements;
- (b) Identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and ~~to~~ plan and perform further audit procedures to appropriately respond to those assessed risks;
- (c) Be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and in evaluating the results of that work; and
- (d) Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, as a basis for forming an opinion on the group financial statements.

## Definitions

**149.** For purposes of the ISAs, the following terms have the meanings attributed below:

- (a) Aggregation risk – The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. (Ref: Para. ~~A18A11~~)
- (b) Component – An entity, ~~or business unit, or a function or business activity, (or some combination thereof),~~ determined by the group auditor for purposes of planning and performing audit procedures in a group audit. (Ref: Para. ~~A19A12~~)
- (c) Component auditor – An auditor who, ~~at the request of the group auditor,~~ performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team<sup>11</sup> for a group audit.<sup>12</sup> (Ref: Para. ~~A20A13–A21A14~~)
- (d) Component management – Management responsible for a component. (Ref: Para. ~~A22A15~~)
- (e) Component performance materiality – An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.
- (f) Group – A reporting entity for which group financial statements are prepared.
- (g) Group audit – The audit of group financial statements.
- (h) Group auditor – The group engagement partner and members of the engagement team other than component auditors. ~~The group auditor who are~~ 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.
- (i) Group audit opinion – The audit opinion on the group financial statements.
- (j) Group engagement partner – The engagement partner<sup>13</sup> who is responsible for the group audit. (Ref: Para. ~~A23A15A~~)
- (k) Group financial statements – Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this ISA, a consolidation process includes: ~~(Ref: Para. A24–A26)~~
  - (i) Consolidation, proportionate consolidation, or an equity method of accounting;
  - (ii) The presentation in combined financial statements of the financial information of entities or business units that have no parent but are under common control or common management; or
  - (iii) The aggregation of the financial information of entities or business units such as branches or divisions. ~~(Ref: Para. A16–A16B)~~
- (l) Group management – Management responsible for the preparation of the group financial

<sup>11</sup> ~~ISA 220 (Revised), paragraph 12(d)~~

<sup>12</sup> ~~ISA 220 (Revised), paragraph 12(d)~~

<sup>13</sup> ISA 220 (Revised), paragraph 12(a)

statements.

- (m) Group performance materiality – Performance materiality<sup>14</sup> in relation to the group financial statements as a whole, as determined by the group auditor.

**1540.** Reference in this ISA to “the applicable financial reporting framework” means the financial reporting framework that applies to the group financial statements.

## Requirements

### Leadership Responsibilities for Managing and Achieving Quality on a Group Audit

**1642.** In applying ISA 220 (Revised),<sup>15</sup> the group engagement partner is required to take overall responsibility for managing and achieving quality on the group audit engagement. In doing so, the group engagement partner shall: (Ref: Para. [A27A19–A28A20](#))

- (a) Take responsibility for creating an environment for the group audit engagement that emphasizes the expected behavior of engagement team members. (Ref: Para. [A29A20A](#))
- (b) Be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement.

### Acceptance and Continuance

**1743.** Before accepting or continuing the group audit engagement, the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements. (Ref: Para. [A30A21–A33A23](#))

**1844.** If, after the acceptance or continuance of the group audit engagement, the group engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the group engagement partner shall consider the possible effects on the group audit. (Ref: Para. [A34A25](#))

### Terms of the Engagement

**1945.** In applying ISA 210,<sup>16</sup> the group auditor shall obtain the agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with: (Ref: Para. [A35A26](#))

- (a) Access to all information of which group management is aware that is relevant to the preparation of the group financial statements such as records, documentation and other matters;
- (b) Additional information that the engagement team may request from group management and component management for the purpose of the group audit; and
- (c) Unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence.

<sup>14</sup> ISA 320, *Materiality in Planning and Performing an Audit*, paragraphs 9 and 11

<sup>15</sup> ISA 220 (Revised), paragraph 13

<sup>16</sup> ISA 210, *Agreeing the Terms of Audit Engagements*, paragraphs 6(b) and 8(b)

*Restrictions on Access to Information and People Outside the Control of Group Management*

**2046.** 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. ~~A27A36–A32A43~~)

*Restrictions on Access to Information and People Imposed by Group Management*

**2147.** If the group engagement partner concludes that: ~~(Ref: Para. A41–A43)~~

- (a) It will not be possible for the group auditor 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 an initial engagement, not accept the engagement, or, in the case of a ~~recurring/continuing~~ engagement, withdraw from the engagement, ~~when~~ withdrawal is possible under applicable law or regulation; or
- (ii) ~~When~~ law or regulation prohibit an auditor from declining an engagement or ~~when~~ 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)~~

**Overall Group Audit Strategy and Group Audit Plan**

**2247A.** In applying ISA 300,<sup>17</sup> the group auditor shall establish, and update as necessary, an overall group audit strategy and group audit plan. ~~In doing so, the group auditor shall determine that includes a determination of:~~ (Ref: Para. ~~A44A33A–A47A33D~~)

- (a) The components at which audit work will be performed; and (Ref: Para. ~~A48A33F~~)
- (b) The resources needed to perform the group audit engagement, including the nature, timing and extent to which component auditors are to be involved. (Ref: Para. ~~A49A33G–A53A33J~~)

*Considerations When Component Auditors Are Involved*

**2348.** In establishing the overall group audit strategy and group audit plan, the group engagement partner shall evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor. (Ref: Para. ~~A54A34~~)

**2449.** As part of the evaluation in paragraph **2348**, the group auditor shall request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. (Ref: Para. ~~A55A35A~~)

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<sup>17</sup> [ISA 300, paragraphs 7–10A](#)

## Relevant Ethical Requirements, Including Those Related to Independence

~~2520~~. In applying ISA 220 (Revised),<sup>18</sup> the group engagement partner shall take responsibility for: (Ref: Para. ~~A56A36–A57A37, A84A52J~~)

- (a) Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and
- (b) Confirming whether the component auditors understand and will comply with the ethical requirements that are relevant to the group audit engagement, including those related to independence.

## Engagement Resources

~~2624~~. In applying ISA 220 (Revised),<sup>19</sup> the group engagement partner shall: (Ref: Para. ~~A58A40A–A65A40B~~)

- (a) Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component; and (~~Ref: Para. A41–A45~~)
- (b) If information about the results of the monitoring and remediation process or external inspections related to the component auditor's ~~firm~~ has been provided by the group auditor's firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor's determination in paragraph ~~2624~~(a).

~~2722~~. The group auditor shall obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving ~~the that~~ component auditor if:

- (a) The component auditor does not comply with the relevant ethical requirements ~~that are relevant to the group audit engagement~~, including those related to independence, that apply to the group audit engagement;<sup>20</sup> or (Ref: Para. ~~A66A46A–A67A47~~)
- (b) The group engagement partner has serious concerns about the matters in paragraphs ~~2318–2624~~. (Ref: Para. ~~A68A48~~)

## Engagement Performance

~~2823~~. In applying ISA 220 (Revised),<sup>21</sup> the group engagement partner shall take responsibility for the nature, timing and extent of direction and supervision of component auditors and the review of their work, taking into account: (Ref: Para. ~~A69A48A–A74A52~~)

- (a) Areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with ISA 315 (Revised 2019); and
- (b) Areas in the audit of the group financial statements that involve significant judgment.

<sup>18</sup> ISA 220 (Revised), paragraph ~~s 16–17 and 24~~

<sup>19</sup> ISA 220 (Revised), paragraphs 25–26

<sup>20</sup> ISA 200, paragraph 14

<sup>21</sup> ISA 220 (Revised), paragraph 29

## Communications with Component Auditors

~~2923A.~~ The group auditor shall communicate with component auditors about their respective responsibilities and the group auditor's expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit. (Ref: Para. ~~A75A52A--A84A52J~~)

~~23B.~~ ~~Communications between the group auditor and component auditors shall take place at appropriate points in time throughout the group audit.~~ (Ref: Para. A52I)

## Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control

~~3024.~~ In applying ISA 315 (Revised 2019),<sup>22</sup> the group auditor shall take responsibility for obtaining an understanding of the following: (Ref: Para. ~~A85A53--A89A55A, A69--A70~~)

- (a) The group and its environment, including: (Ref: Para. ~~A90A56--A92A58~~)
  - (i) The group's organizational structure and its business model, including:
    - a. The locations in which the group has its operations or activities;
    - b. The nature of the group's operations or activities and the extent to which they are similar across the group; and
    - c. The extent to which the group's business model integrates the use of IT;
  - (ii) Regulatory factors impacting the entities and business units in the group; and
  - (iii) The measures used internally and externally to assess the entities or business units' financial performance;
- (b) The applicable financial reporting framework and the consistency of accounting policies and practices across the group; and
- (c) The group's system of internal control, including:
  - (i) The nature and extent of commonality of controls; (Ref: Para. ~~A93A59--A97, A100A63~~)
  - (ii) Whether, and if so, how, the group centralizes activities relevant to financial reporting; (Ref: Para. ~~A98A64--A100A65A~~)
  - (iii) The consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments; and
  - (iv) How group management communicates significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group's system of internal control to management of entities or business units. (Ref: Para. ~~A101A66--A103A68~~)

<sup>22</sup> ISA 315 (Revised 2019), paragraphs 19–~~27~~<sup>6</sup>

### *Considerations When Component Auditors Are Involved*

**3126.** The group auditor shall communicate to component auditors on a timely basis: (Ref: Para. A104)

- (a) Matters that the group auditor determines to be relevant to the component auditor's design or performance of risk assessment procedures for purposes of the group audit;
- (b) In applying ISA 550,<sup>23</sup> related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor; and (Ref: Para. ~~A105A72~~)
- (c) In applying ISA 570 (Revised),<sup>24</sup> events or conditions identified by group management or the group auditor, that may cast significant doubt on the group's ability to continue as a going concern that are relevant to the work of the component auditor.

**3226A.** The group auditor shall request component auditors to communicate on a timely basis: ~~(Ref: Para. A72A)~~

- (a) Matters related to the financial information of the component that may be relevant to the identification and assessment of the risks of material misstatement of the group financial statements, whether due to fraud or error;
- (b) Related party relationships not previously identified by group management or the group auditor; and
- (c) Any events or conditions identified by the component auditor that may cast significant doubt on the group's ability to continue as a going concern.

### **Identifying and Assessing the Risks of Material Misstatement**

**3326B.** In applying ISA 315 (Revised 2019),<sup>25</sup> based on the understanding obtained in paragraph ~~3024~~, the group auditor shall take responsibility for the identification and the assessment of the risks of material misstatement of the group financial statements, including with respect to the consolidation process. (Ref: Para. ~~A106A72B–A111A72G~~)

### *Considerations When Component Auditors Are Involved*

**3426C.** In applying ISA 315 (Revised 2019),<sup>26</sup> the group auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements. (Ref: Para. ~~A112A72H–A113A72I~~)

### **Materiality**

**3529.** In applying ISA 320<sup>27</sup> and ISA 450,<sup>28</sup> when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, the group auditor shall determine:

<sup>23</sup> ISA 550, *Related Parties*, paragraph 17

<sup>24</sup> ISA 570 (Revised), *Going Concern*

<sup>25</sup> ISA 315 (Revised 2019), paragraphs 28–34

<sup>26</sup> ISA 315 (Revised 2019), paragraph 35

<sup>27</sup> ISA 320, paragraph 11

<sup>28</sup> ISA 450, *Evaluation of Misstatements Identified during the Audit*, paragraph 5

- (a) Component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality. (Ref: Para. ~~A114A73–A118A76~~)
- (b) The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor. Such threshold shall not exceed the amount regarded as clearly trivial to the group financial statements. (Ref: Para. ~~A119A77~~)

#### *Considerations When Component Auditors Are Involved*

~~3630~~. The group auditor shall communicate to the component auditor the amounts determined in accordance with paragraph ~~3529~~. (Ref: Para: ~~A120A77A–A121A77B~~)

#### **Responding to the Assessed Risks of Material Misstatement**

~~3733~~. In applying ISA 330,<sup>29</sup> the group auditor shall take responsibility for the nature, timing and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing and extent of the work to be performed at those components. (Ref: Para. ~~A122A86–A137A93A~~)

#### *Consolidation Process*

~~3834~~. The group auditor shall take responsibility for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This shall include: ~~(Ref: Para. A138)~~

- (a) Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub-consolidations; ~~(Ref: Para. A94)~~
- (b) Responding to the assessed risks of material misstatement due to fraud in the consolidation process, including when ~~or~~ indicators of possible management bias have been identified that exist in the consolidation process; and
- (c) Evaluating the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications. (Ref: Para. ~~A139A95~~)

~~3935~~. If the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group auditor shall evaluate whether the financial information has been appropriately adjusted for purposes of preparing and presenting the group financial statements.

~~4036~~. If the group financial statements include the financial information of an entity or business unit with a financial reporting period-end that differs from that of the group, the group auditor shall take responsibility for evaluating whether appropriate adjustments have been made to that financial information in accordance with the applicable financial reporting framework.

#### *Considerations When Component Auditors Are Involved*

~~4137~~. When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor shall communicate with component auditors matters that the group auditor or component auditor determines to be ~~are~~ relevant to the design of responses to the assessed risks of material misstatement of the group financial statements.

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<sup>29</sup> ISA 330, paragraphs 6–7

~~4238~~. For areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with ISA 315 (Revised 2019), on which a component auditor is determining the further audit procedures to be performed, the group auditor shall evaluate the appropriateness of the design and performance of those further audit procedures. (Ref: Para. [A140A95A](#))

~~4339~~. ~~In accordance with paragraph 23, When component auditors perform further audit procedures on the consolidation process, including on sub-consolidations,~~ the group auditor shall determine the nature and extent of direction and supervision of component auditors and the review of their work ~~when component auditors perform further audit procedures on the consolidation process, including on sub-consolidations.~~ (Ref: Para. [A141A102](#))

~~4440~~. The group auditor shall determine whether the financial information identified in the component auditor's communication (see paragraph ~~4544~~(a)) is the financial information that is incorporated in the group financial statements.

### **Evaluating the Component Auditor's Communications and the Adequacy of Their Work** **Communication about Matters Relevant to the Group Auditor's Conclusion**

~~4544~~. The group auditor shall request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication shall include: (Ref: Para. [A142A111A](#))

- (a) Identification of the financial information on which the component auditor has been requested to perform audit procedures;
- ~~(baa)~~ Whether the component auditor has performed the work requested by the group auditor;
- ~~(cab)~~ Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that ~~are relevant~~apply to the group audit, ~~including those related to independence~~;
- ~~(db)~~ Information ~~on~~ about instances of non-compliance with laws or regulations;
- ~~(ee)~~ Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph ~~3630~~; (Ref: Para. [A143A111B](#))
- ~~(fd)~~ Indicators of possible management bias;
- ~~(ge)~~ Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed;
- ~~(hf)~~ Fraud or suspected fraud involving component management, employees who have significant roles in the group's system of internal control at the component or others where the fraud resulted in a material misstatement of the component financial information ~~of the component~~;
- ~~(ifa)~~ Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component;
- ~~(ig)~~ Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in the written representations that the component auditor requested from component management; and

(k~~h~~) The component auditor's overall findings or conclusions. (Ref: Para. [A144A112A](#))

~~4645.~~ The group auditor shall:

- (a) Discuss significant matters arising from ~~the~~ communications with the component auditor, including those in accordance with paragraph 45, with the component auditor, component management or group management, as appropriate; and
- (b) Evaluate whether the communications with the component auditor~~s, including those in accordance with paragraph 44,~~ are adequate for the group auditor's purposes. If such communications are not adequate for the group auditor's purposes, the group auditor shall consider the implications for the group audit.

~~4745A.~~ ~~Based on the evaluation required by paragraph 45(b), t~~he group auditor shall ~~also~~ determine whether, and the extent to which, it is necessary to review additional component auditor audit documentation. In making this determination, the group auditor shall consider: (Ref: Para. ~~A145-A112B-A146A113~~)

- (a) The nature, timing and extent of the work performed by the component auditor;
- (b) The competence and capabilities of the component auditor as determined in accordance with paragraph ~~2621~~(a); and
- (c) The direction and supervision of the component auditor and review of their work.

~~46.~~ ~~If the group auditor determines that the component auditors' communications are not adequate for the group auditor's purposes, the group auditor shall consider whether further information can be obtained from component auditors or other sources. If such information cannot be obtained from component auditors or through other sources, the group auditor shall consider the implications for the group audit, in accordance with paragraph 51.~~

~~48.~~ If the group auditor concludes that the work of the component auditor is ~~insufficient~~not adequate for the group auditor's purposes, the group auditor shall determine what additional audit procedures are to be performed, and whether they are to be performed by a component auditor or by the group auditor. [Previously paragraph 51 as presented in the September 2021 draft]

### Subsequent Events

~~4947.~~ In applying ISA 560,<sup>30</sup> the group auditor shall take responsibility for performing procedures, including, as appropriate, requesting component auditors to perform procedures, designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: Para. [A147A114](#))

#### *Considerations When Component Auditors Are Involved*

~~5048.~~ The group auditor shall request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements. (Ref: Para. [A147A114](#))

<sup>30</sup> ISA 560, *Subsequent Events*, paragraphs ~~6-7~~

## Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

**5149.** In applying ISA 330,<sup>31</sup> the group auditor shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including from the work performed by component auditors, on which to base the group audit opinion. (Ref: Para. [A148A114A–A152A115C](#))

### *Evaluating the Effect on the Group Audit Opinion*

**5250.** The group engagement partner shall evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) and any instances ~~where~~when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: Para. [A153A116](#))

### *Considerations When Component Auditors Are Involved*

[Paragraph 51 as presented in the September 2021 draft is now paragraph 48]

## Auditor's Report

**5352.** The auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor's report shall indicate that the reference does not diminish the group engagement partner's or the group engagement partner's firm's responsibility for the group audit opinion. (Ref: Para. [A154A117–A155A118](#))

## Communication with Group Management and Those Charged with Governance of the Group

### *Communication with Group Management*

**5453A.** The group auditor shall communicate with group management an overview of the planned scope and timing of the audit, including an overview of the work to be performed at components of the group. (Ref: Para. [A156A119A](#))

**5554.** If fraud has been identified by the group auditor or brought to its attention by a component auditor (see paragraph ~~45(h)44(f)~~), or information indicates that a fraud may exist, the group auditor shall communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities. (Ref: Para. [A157A120](#))

**5655.** A component auditor may be required by statute, regulation or ~~for another~~other reasons, to express an audit opinion on the financial statements of an entity or business unit that forms part of the group. In that case, the group auditor shall request group management to inform management of the entity or business unit of any matter of which the group auditor becomes aware that may be significant to the financial statements of the entity or business unit, but of which management of the entity or business unit may be unaware. If group management refuses to communicate the matter to management of the entity or business unit, the group auditor shall discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group auditor, subject to legal and professional confidentiality considerations, shall consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the entity or business unit until the matter is resolved. (Ref: Para. [A158–A159A124](#))

<sup>31</sup> ISA 330, paragraph 26

### *Communication with Those Charged with Governance of the Group*

**5756.** The group auditor shall communicate the following matters with those charged with governance of the group, in addition to those required by ISA 260 (Revised)<sup>32</sup> and other ISAs: (Ref: Para. [A160A122](#))

- (a) An overview of the work to be performed at the components of the group and the nature of the group auditor's planned involvement in the work to be performed by component auditors. (Ref: Para. [A161A123](#))
- (b) Instances when the group auditor's review of the work of a component auditor gave rise to a concern about the quality of that component auditor's work, and how the group auditor addressed the concern.
- (c) Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information.
- (d) Fraud or suspected fraud involving group management, component management, employees who have significant roles in the group's system of internal control or others when the fraud resulted in a material misstatement of the group financial statements.

### *Communication of Identified Deficiencies in Internal Control*

**5856A.** In applying ISA 265,<sup>33</sup> the group auditor shall determine whether any identified deficiencies in the group's system of internal control are required to be communicated to those charged with governance of the group or group management. In making this determination, the group auditor shall consider deficiencies in internal control that have been identified by component auditors and communicated to the group auditor in accordance with paragraph [45\(g\)44\(e\)](#). (Ref: Para. [A162A123A](#))

### **Documentation**

**5957.** In accordance with ISA 230,<sup>34</sup> the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying ISA 230,<sup>35</sup> the group auditor shall include in the audit documentation: (Ref: Para. [A163A123B–A166A124x](#), [A176A129–A179A130A](#))

- (a) Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed.
- (b) The basis for the group auditor's determination of components for purposes of planning and performing the group audit. (Ref: Para. [A167A124y](#))
- (c) The basis for the determination of component performance materiality and the threshold for communicating misstatements in the component financial information to the group auditor.

<sup>32</sup> ISA 260 (Revised), *Communication with Those Charged with Governance*

<sup>33</sup> ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance and Management*

<sup>34</sup> [ISA 230, paragraph 8](#)

<sup>35</sup> ISA 230, paragraphs 1–3, ~~89~~–11, A6–A7 and Appendix

- (~~dea~~) The basis for the group auditor's determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components. (Ref: Para. ~~A168A124z~~)
- (~~eeb~~) Key elements of the understanding of the group's system of internal control in accordance with paragraph ~~3024~~(c);
- (~~fd~~) The nature, timing and extent of the group auditor's direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor's review of ~~parts of the additional~~ component auditor's audit documentation in accordance with paragraph ~~4745A~~. (Ref: Para. ~~A169A124D–A175A128~~)
- (~~ge~~) Matters related to communications with component auditors, including:
  - (i) Matters, if any, related to fraud, related parties or going concern communicated in accordance with paragraph ~~3226A~~.
  - (ii) Matters relevant to the group auditor's conclusion with regard to the group audit, in accordance with paragraph ~~4544~~, including how the group auditor has addressed significant matters discussed with component auditors, component management or group management.
- (~~hf~~) The group auditor's evaluation of, and response to, findings or conclusions of the component auditors about matters that could have a material effect on the group financial statements.

\* \* \*

## Application and Other Explanatory Material

### Scope of this ISA (Ref: Para. 1–~~21B~~)

- A1. This ISA also deals with the special considerations for the group engagement partner or group auditor, as applicable, in applying the requirements and guidance in ISA 220 (Revised), including for the direction and supervision of component auditors and the review of their work.
- A2. ISQM 1<sup>36</sup> addresses the engagements for which an engagement quality review is required to be performed. ISQM 2<sup>37</sup> deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review, including for a group audit.

~~A3A2A~~. An entity or business unit of a group may also prepare its own group financial statements that incorporate the financial information of those entities or business units it encompasses (that is, a sub-group). This ISA applies to an audit of the group financial statements of such sub-groups performed for statutory, regulatory or other reasons.

~~A4A2AA~~. A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a bank with multiple branches. When those business units have characteristics such as separate locations, separate management, or separate information systems (including a separate general ledger) and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information

<sup>36</sup> International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*

<sup>37</sup> ISQM 2, *Engagement Quality Reviews*

of more than one entity or business unit through a consolidation process.

**A5A2B.** In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this ISA.

#### *Groups and Components* (Ref: Para. ~~43–53A~~)

**A6A3A.** The group's information system, including its financial reporting process, may or may not be aligned with the group's organizational structure. For example, a group may be organized according to its legal structure, but its information system may be organized by function, process, product or service (or by groups of products or services), or geographic locations for management or reporting purposes.

**A7A5.** Based on the understanding of the group's organizational structure and information system, the group auditor may determine that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the group auditor may decide to treat these three legal entities as one component.

**A8A6.** A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example through the use of a shared service center. When such centralized activities are relevant to the group's financial reporting process, the group auditor may determine that the shared service center is a component.

**A9A6A.** Another consideration that may be relevant to the group auditor's determination of components is how management has determined operating segments in accordance with the disclosure requirements of the applicable financial reporting framework.<sup>38</sup>

#### *Involvement of Component Auditors* (Ref: Para. ~~63B–84~~)

**A10A8AA.** Component auditors may perform an audit of the financial statements of a component, whether for statutory, regulatory or other reasons, particularly when a component is a legal entity. When a component auditor is also performing or has completed an audit of the component financial statements, the group auditor may be able to use audit work performed on the component financial statements, provided the group auditor is satisfied that such work is appropriate for purposes of the group audit. In addition, ~~some of the audit work requested by the group auditor may be able to be used by the component auditor for the separate audit of the component financial statements.~~ Component auditors may ~~also~~ adapt the work ~~they performed~~ on the audit of the component financial statements to also meet the needs of the group auditor. In any event, the requirements of this ISA apply, including those relating to the direction and supervision of component auditors and the review of their work.

<sup>38</sup> See, for example, International Financial Reporting Standard (IFRS) 8, *Operating Segments*

**A11A8A.** As explained in ISA 200,<sup>39</sup> detection risk relates to the nature, timing and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. Detection risk is a function not only of the effectiveness of an audit procedure but also the application of that procedure by the auditor. Therefore, detection risk is influenced by matters such as adequate planning, the assignment of appropriate resources to the engagement, the exercise of professional skepticism, and the supervision and review of the audit work performed.

**A12A8B.** Detection risk is a broader concept than aggregation risk as described in paragraphs 149(a) and A18A11. In a group audit, there may be a higher probability that the aggregate of uncorrected and undetected misstatements may exceed materiality for the group financial statements as a whole because audit procedures may be performed separately on the financial information of components across the group. Accordingly, component performance materiality is set by the group auditor to reduce aggregation risk to an appropriately low level.

*Professional Skepticism* (Ref: Para. 95)

**A13A9.** ISA 220 (Revised)<sup>40</sup> provides examples of the impediments to the exercise of professional skepticism at the engagement level, including unconscious auditor biases that may impede the exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. ISA 220 (Revised) also provides possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level.

**A14.** Requirements and relevant application material in ISA 315 (Revised 2019),<sup>41</sup> ISA 540 (Revised)<sup>42</sup> and other ISAs ~~also provide examples of areas in an audit where~~ address the auditor exercises of professional skepticism, ~~or and include~~ examples of ~~where how appropriate~~ documentation may help provide evidence about how of the auditor's exercised of professional skepticism. [Previously paragraph A10 as presented in the September 2021 draft]

**A15A9AA.** ~~It is important for a~~ All members of the engagement team, including component auditors, are required to exercise professional skepticism throughout the group audit. ~~When there are a large number of components across multiple jurisdictions, it also may be important for the group auditor to remain alert for inconsistent information from component auditors, component management and group management about matters that may be significant to the group financial statements.~~ The group auditor's direction and supervision of engagement team members, including component auditors, and the review of their work may help inform the group auditor ~~in evaluating about~~ whether the engagement team has appropriately exercised professional skepticism.

**A16A9A.** The exercise of professional skepticism in a group audit ~~also~~ may be affected by matters such as the following:

- Component auditors in different locations may be subject to varying cultural influences, which may affect the nature of the biases to which they are subject.
- The complex structure of some groups may introduce factors that give rise to increased susceptibility to risks of material misstatement. In addition, an overly complex

<sup>39</sup> ISA 200, paragraph A45

<sup>40</sup> ISA 220 (Revised), paragraphs ~~A35A34~~–A36

<sup>41</sup> ISA 315 (Revised 2019), paragraph A238

<sup>42</sup> ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraph A11

organizational structure may ~~itself~~ be a fraud risk factor in accordance with ISA 240<sup>43</sup> and therefore may require additional time or expertise to understand the business purpose and activities of certain entities or business units.

- The nature and extent of intra-group transactions (e.g., transactions that involve multiple entities and business units within the group or multiple related parties), cash flows or transfer pricing agreements may give rise to additional complexities. In some cases, such matters may also give rise to fraud risk factors.
- When the group audit is subject to tight reporting deadlines imposed by group management, this may put pressure on engagement team members in completing the work assigned. For example, ~~such demands may restrict the ability of~~ the engagement team may not have (or otherwise take) the time needed to appropriately question management's assertions, make appropriate judgments, ~~or appropriately including in the review of the audit work performed, and appropriately question management's assertions.~~

~~A17A9C. The group auditor's direction and supervision of engagement team members, including component auditors, and the review of their work may help the group auditor in evaluating whether the engagement team has appropriately exercised professional skepticism. The group auditor also may need to remain alert for inconsistent information from component auditors, component management and group management about matters that may be significant to the group financial statements.~~

A10. [Paragraph A10 as presented in the September 2021 draft is now paragraph A14]

## Definitions

*Aggregation Risk* (Ref: Para. 149(a))

A18A11. Aggregation risk exists in all audits of financial statements, but is particularly important to understand and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances or disclosures that are disaggregated across components. Generally, aggregation risk increases as the number of components increases at which audit procedures are performed separately, whether by component auditors or other members of the engagement team.

*Component* (Ref: Para. 149(b))

~~A19A12. As noted in paragraph 3A, t~~The group auditor uses professional judgment in determining components at which audit procedures work will be performed, ~~including whether~~ Paragraph A7 explains that the financial information of certain entities or business units, ~~functions or business activities will~~ may be considered together for purposes of planning and performing audit procedures. However, the group auditor's responsibility for the identification and assessment of the risks of material misstatement of the group financial statements ~~in accordance with ISA 315 (Revised 2019)~~ encompasses all of the entities and business units whose financial information is included in the group financial statements.

*Component Auditor* (Ref: Para. 149(c))

A20A13. References in this ISA to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (e.g., another office within the group auditor's firm).

<sup>43</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*, Appendix 1

A21A14. In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor ~~for purposes of this ISA.~~

*Component Management* (Ref: Para. 149(d))

A22A15. Component management refers to management responsible for the financial information or other activity (e.g., processing of transactions at a shared service center) at an entity or business unit that is part of the group. When the group auditor considers the financial information of certain entities or business units together as a component or determines that a shared service center is a component (see paragraphs A75–A86), component management refers to the management that is responsible for the financial information or transaction processing that is subject to the audit procedures being performed in relation to that component. In some circumstances, there may not be separate component management and group management may be responsible for the financial information or other activities of the component.

*Group Engagement Partner* (Ref: Para. 149(j))

A23A15A. When joint auditors conduct a group audit, the joint engagement partners and their engagement teams collectively constitute the “group engagement partner” and “engagement team” for the purposes of the ISAs. This ISA does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor for purposes of the group audit.

*Group Financial Statements* (Ref: Para. 21A, 149(k))

A24A16. The requirements for the preparation and presentation of the group financial statements may be specified in the applicable financial reporting framework, which may therefore affect the determination of the financial information of entities or business units to be included in the group financial statements. For example, some frameworks require the preparation of consolidated financial statements when an entity (a parent entity) controls one or more other entities (e.g., subsidiaries) through majority ownership interest or other means. In some cases, the applicable financial reporting framework includes separate requirements for, or may otherwise permit, the presentation of combined financial statements. Examples of circumstances in which the presentation of combined financial statements may be permitted include entities that have no parent but are under common control or entities under common management.

A25A16A. The term “consolidation process” as used in this ISA is not intended to have the same meaning as “consolidation” or “consolidated financial statements” as defined or described in financial reporting frameworks. Rather, the term “consolidation process” refers more broadly to the process used to prepare group financial statements. ~~Also see paragraph 1A.~~

A26A16B. The detailed aspects of the consolidation process vary from one group to another, depending on the group’s structure and information system, including the financial reporting process. However, a consolidation process involves considerations such as the elimination of intra-group transactions and balances and, when applicable, implications of different reporting periods for entities or business units included in the group financial statements.

## Leadership Responsibilities for Managing and Achieving Quality on a Group Audit (Ref: Para. 116, 1642)

A27A19. It may not be possible or practical for the group engagement partner to solely deal with all requirements in ISA 220 (Revised), particularly when the engagement team includes a large number of component auditors located in multiple locations. In managing quality at the engagement level, ISA 220 (Revised)<sup>44</sup> permits the engagement partner to assign ~~responsibilities for~~ the design or performance of procedures, tasks or actions to ~~other appropriately skilled or suitably experienced~~ members of the engagement team to assist the engagement partner. Accordingly, the group engagement partner may assign procedures, tasks or actions~~responsibilities~~ to other members of the engagement team and these members may assign procedures, tasks or actions~~responsibilities~~ further. In such circumstances, ISA 220 (Revised) requires that the engagement partner shall continue to take overall responsibility for managing and achieving quality on the audit engagement.<sup>45</sup>

A28A20. Policies or procedures established by the firm, or that are common network requirements or network services,<sup>46</sup> may support the group engagement partner by facilitating communication between the group auditor and component auditors and supporting the group auditor's direction and supervision of those component auditors and the review of their work.

~~A29A20A. In addressing the requirements in paragraph 12(a) of this ISA, direct communication with other members of the engagement team, including component auditors and leading by example in the group engagement partner's personal conduct and actions helps to reinforce a commitment to quality. As explained in~~ ISA 220 (Revised),<sup>47</sup> explains that a culture that demonstrates a commitment to quality is ~~further~~ shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. In addressing the requirement in paragraph 16(a), the group engagement partner may communicate directly to other members of the engagement team (including component auditors) and reinforce this communication through personal conduct and actions (e.g., leading by example). Doing so may help to reinforce a commitment to quality.

## Acceptance and Continuance

*Determining Whether Sufficient and Appropriate Audit Evidence Can Reasonably Be Expected ~~To~~ Be Obtained* (Ref: Para. ~~1743–1844~~)

A30A21. In determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, the group engagement partner may obtain an understanding of matters such as:

- The group structure, including both the legal and organizational structure.
- Activities that are significant to the group, including the industry and regulatory, economic and political environments in which those activities take place.
- The use of service organizations.
- The use of shared service centers.
- The consolidation process.

<sup>44</sup> ISA 220 (Revised), paragraph 15

~~<sup>45</sup> ISA 220 (Revised), paragraph 15~~

<sup>46</sup> ISQM 1, paragraphs 48–52

<sup>47</sup> ISA 220 (Revised), paragraph A28

- Whether the group auditor:
  - Will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management and, component information, including of those components that are accounted; and for by the equity method; and
  - Will be able to perform necessary work on the financial information of the components when applicable.
- Whether sufficient and appropriate resources are assigned or will be made available.

[Paragraph A21A as presented in the September 2021 draft is now paragraph A33]

A31A22. In the case of an initial group audit engagement, the group auditor's understanding of the matters in paragraph A30A24 may be obtained from:

- Information provided by group management;
- Communication with group management;
- Communication with those charged with governance of the group; and
- Where-When applicable, communication with component management or the predecessor auditor.

A32A23. For a recurring/continuing engagement, obtaining sufficient appropriate audit evidence may be affected by significant changes, for example:

- Changes in the group structure (e.g., acquisitions, disposals, joint ventures, reorganizations, or changes in how the group financial reporting system is organized).
- Changes in components' activities that are significant to the group.
- Changes in the composition of those charged with governance of the group, group management, or key management of components for which audit procedures are expected to be performed.
- New concerns the group auditor has with regard to the integrity and competence of group or component management.
- Changes in the applicable financial reporting framework.

A33A24. There may be more-additional complexities with obtaining sufficient appropriate audit evidence in a group audit with-when components are located in jurisdictions other than the group auditor's jurisdiction because of cultural and language differences, and different laws or regulations. Law or regulation may restrict the component auditor from providing documentation outside of its jurisdiction, or war, civil unrest or outbreaks of disease may restrict the group auditor's access to relevant component auditor documentation. Paragraph A177 includes possible ways to address these situations. (e.g., regulations restricting access to audit documentation (see paragraphs A129–A130)). [Previously paragraph A21A as presented in the September 2021 draft]

A34A25. Restrictions may be imposed after the group engagement partner's acceptance of the group audit engagement that may affect the engagement team's ability to obtain sufficient appropriate audit evidence. Such restrictions may include those affecting:

- The group auditor's access to component information, management or those charged with governance of components, or the component auditors (including relevant audit

documentation sought by the group auditor) (see paragraphs [2046](#) and [2147](#)); or

- The work to be performed on the financial information of components.

~~Paragraphs A42–A43 explain the possible effect of such restrictions on the auditor’s report on the group financial statements. An inability to obtain sufficient appropriate audit evidence would need to be evaluated, in accordance with ISA 705 (Revised),<sup>48</sup> in forming an opinion on the group financial statements. ISA 705 (Revised)<sup>49</sup> also addresses circumstances in which such restrictions may lead to withdrawal from the engagement, where withdrawal is possible under applicable law or regulation.~~

#### *Agreeing the Terms of Audit Engagements* (Ref: Para. [1945](#))

[A35A26](#). ISA 210<sup>50</sup> requires the auditor to agree the terms of the audit engagement with management or those charged with governance, as appropriate.<sup>54</sup> The terms of engagement identify the applicable financial reporting framework.<sup>52</sup> Additional matters that may be included in the terms of a group audit engagement ~~include, such as:~~

- Communications between the group auditor and component auditors should be unrestricted to the extent possible under laws or regulations;
- Important communications between component auditors and those charged with governance of the component or component management, including communications on significant deficiencies in internal control, should be communicated to the group auditor;
- Communications between regulatory authorities and entities or business units related to financial reporting matters that may be relevant to the group audit should be communicated to the group auditor; and
- The group auditor should be permitted to perform work, or request a component auditor to perform work, at the component.

#### *Restrictions on Access to Information or People* (Ref: Para. [2046–2147](#))

[A36A27](#). Restrictions on access to information or people do not ~~eliminate~~alleviate the requirement for the group auditor to obtain sufficient appropriate audit evidence.

[A37A28](#). Access to information or people can be restricted for many reasons, such as restrictions imposed by component management, laws or regulations or other conditions, for example, war, civil unrest or outbreaks of disease. Paragraph [A177A130](#) describes how the group auditor may be able to overcome restrictions on access to component auditor audit documentation.

[A38A29](#). In some circumstances, the group auditor may be able to overcome restrictions on access to information or people, for example:

- If access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the

<sup>48</sup> ~~ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor’s Report*~~

<sup>49</sup> ~~ISA 705 (Revised), paragraph 13(b)(i)~~

<sup>50</sup> ~~ISA 210, paragraph 9 and 10(d)~~

<sup>54</sup> ~~ISA 210, paragraph 9~~

<sup>52</sup> ~~ISA 210, paragraph 10~~

group.

- If the group has a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may ~~be able to overcome restrictions by~~ determining whether provisions exist (e.g., in the terms of joint venture agreements, or the terms of other investment agreements) regarding access by the group to the financial information of the entity, and ~~requesting group~~ management to exercise such rights.
- If the group has a non-controlling interest in an entity that is accounted for by the equity method and the group has representatives who are on the executive board or are members of those charged with governance of the non-controlled entity, the group auditor may ~~inquire discuss with them the non-controlled entity's operations and financial status and whether they can provide obtain~~ financial and other information available to them in their roles.

A39A29A. ~~If~~When the group has a non-controlling interest in an entity that is accounted for by the equity method and the group auditor's access to information or people at the entity is restricted, the group auditor may ~~still~~ be able to obtain information to be used as audit evidence ~~in respect of~~regarding the entity's financial information, for example:

- Financial information that is available from group management, as group management also needs to obtain the non-controlled entity's financial information in order to prepare the group financial statements.
- Publicly available information, such as audited financial statements, public disclosure documents, or quoted prices of equity instruments in the non-controlled entity.

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can overcome the restrictions to enable the group auditor to obtain sufficient appropriate audit evidence.<sup>53</sup>

A40A30. When the group auditor cannot overcome restrictions on access to information or people:

- ~~C~~C, ~~o~~ommunicating the restrictions to the group auditor's firm can assist the group auditor in determining an appropriate course of action. For example, the group auditor's firm may ~~o~~ommunicate ~~about the restrictions~~ with group management about the restrictions and encourage group management to communicate with regulators. This may be useful when restrictions affect multiple audits in the jurisdiction or by the same firm, for example, because of war, civil unrest or outbreaks of disease in a major economy.
- For a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may discuss with group management whether restrictions on group management's ability to provide access to information or people indicate that the equity method of accounting may not be appropriate in accordance with the applicable financial reporting framework.
- The group auditor may b~~B~~e required by law or regulation to communicate with regulators, listing authorities, or others, about the restrictions ~~or how to overcome the restrictions~~.

<sup>53</sup> ISA 330, paragraph 7(b)

**A41A34.** Restrictions on access may have other implications for the group audit. For example, if restrictions are imposed by group management, the group auditor may need to reconsider the reliability of group management's responses to the group auditor's inquiries and whether the restrictions may call into question group management's integrity.

*Effect of Restrictions on Access to Information or People on the Auditor's Report on Group Financial Statements*

**A42A32.** ISA 705 (Revised)<sup>54</sup> contains requirements and guidance about how to address situations when ~~the~~ the group auditor is unable to obtain sufficient appropriate audit evidence. Appendix ~~12 to this ISA~~ contains an example of an auditor's report containing a qualified group audit opinion based on the group auditor's inability to obtain sufficient appropriate audit evidence in relation to a component that is accounted for by the equity method.

*Law or Regulation Prohibit the Group Engagement Partner from Declining or Withdrawing from an Engagement*

**A43A33.** Law or regulation may prohibit the group engagement partner from declining or withdrawing from an engagement. For example, in some jurisdictions the auditor is appointed for a specified period of time and is prohibited from withdrawing before the end of that period. Also, in the public sector, the option of declining or withdrawing from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, the requirements in this ISA still apply to the group audit, and the effect of the group auditor's inability to obtain sufficient appropriate audit evidence is addressed in ISA 705 (Revised).

**Overall Group Audit Strategy and Group Audit Plan**

*The Continual and Iterative Nature of Planning and Performing a Group Audit (Ref: Para. 2247A)*

**A44A33A.** As explained in ISA 300,<sup>55</sup> planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. For example, due to unexpected events, changes in conditions, or audit evidence obtained from risk assessment or further audit procedures, the group auditor may need to modify the overall group audit strategy and group audit plan, and the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. The group auditor may also modify the determination of the components at which to perform audit work as well as the nature, timing and extent of the component auditors' involvement. ISA 300<sup>56</sup> requires the auditor to update and change the overall audit strategy and audit plan as necessary during the course of the audit.

*Establishing the Overall Group Audit Strategy and Group Audit Plan (Ref: Para. 2247A)*

**A45A33B.** In an initial group audit engagement, the group auditor may have a preliminary understanding of the group and its environment, the applicable financial reporting framework and the entity's system of internal control based on information obtained from group management, those charged with governance of the group and, when ~~the~~ applicable, communication with

<sup>54</sup> ISA 705 (Revised), Modifications to the Opinion in the Independent Auditor's Report

<sup>55</sup> ISA 300, paragraph A2

<sup>56</sup> ISA 300, paragraph 10

component management or the predecessor auditor. In a recurring group audit engagement, the group auditor's preliminary understanding may be obtained through ~~the~~ prior period's audits. This preliminary understanding may assist the group auditor in developing initial expectations about the classes of transactions, account balances and disclosures that may be significant.

**A46A33C.** The group auditor may also use information obtained during the engagement acceptance and continuance process in establishing the overall group audit strategy and group audit plan, for example, in relation to the resources needed to perform the group audit.

**A47A33D.** The process of establishing the overall group audit strategy and group audit plan and initial expectations about the classes of transactions, account balances and disclosures that may be significant at the group financial statement level may assist the group auditor in developing a preliminary determination of matters such as:<sup>57</sup>

- Whether to perform audit work centrally, at components or a combination thereof; and
- The nature, timing and extent of audit work to be performed with respect to the financial information of ~~a~~ components (e.g., design and perform risk assessment procedures, further audit procedures, or a combination thereof).

*Components at Which to Perform Audit Work* (Ref: Para. **2247A(a)**)

**A48A33F.** The determination of components at which to perform audit work is a matter of professional judgment. Matters that may influence the group auditor's determination include, for example:

- The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example:
  - Newly formed or acquired entities or business units.
  - Entities or business units in which significant changes have taken place.
  - Significant transactions with related parties.
  - Significant transactions outside the normal course of business.
  - Abnormal fluctuations identified by analytical procedures performed at the group level, ~~in accordance with as required by~~ ISA 315 (Revised 2019).<sup>58</sup>
- The disaggregation of significant classes of transactions, account balances and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities and transactions, at the location or business unit relative to the group financial statements.
- Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances and disclosures in the group financial statements from audit work planned on the financial information of identified components.
- The nature and extent of misstatements or control deficiencies identified at ~~at~~ the component in prior period audits.
- The nature and extent of the commonality of controls across the group~~common controls~~ and whether, and if so, how, the group centralizes activities relevant to financial reporting.

<sup>57</sup> ~~ISA 315 (Revised 2019), paragraph 7~~

<sup>58</sup> ISA 315 (Revised 2019), paragraph 14(b)

Resources (Ref: Para. 2247A(b))

A49A33G. ~~Matters~~Factors that influence the group auditor's determination of the resources needed to perform the group audit and the nature, timing and extent to which component auditors are to be involved are a matter of professional judgment and may include, for example:

- The understanding of the group, the components within the group at which audit work is to be performed and whether to perform work centrally, at components or a combination thereof.
- The knowledge and experience of the engagement team. For example, component auditors may have greater experience and a more in-depth knowledge than the group auditor of the local industries in which components operate, local laws or regulations, business practices, language and culture. In addition, the involvement of experts may be needed on complex matters.
- The initial expectations about the potential risks of material misstatement.
- The amount or location of resources to allocate to specific audit areas. For example, the extent to which components are dispersed across multiple locations may impact the need to involve component auditors in specific locations.
- Access arrangements. For example, when the group auditor's access to a component in a particular jurisdiction is restricted, component auditors may need to be involved.
- The nature of the components' activities, including their complexity or specialization of operations.
- The group's system of internal control, including the information system in place, and its degree of centralization. For example, the involvement of component auditors may be more likely when the system of internal control is decentralized.
- Previous experience with the component auditor.

A50A33H. Component auditors may be involved ~~throughout the~~in different phases of an audit, for example, component auditors may design or perform:

- ~~R~~Perform risk assessment procedures; and
- Procedures to Respond~~respond~~ to the assessed risks of material misstatement.

A51. The nature, timing and extent to which component auditors are to be involved depends on the facts and circumstances of the group audit engagement. Often component auditors will be involved in all phases of the audit, but the group auditor may decide to involve component auditors only in a certain phase. When the group auditor does not intend to involve component auditors in risk assessment procedures, the group auditor may still discuss with component auditors whether there are any significant changes in the business or the system of internal control of the component that could have an effect on the risks of material misstatement of the group financial statements. [Paragraph A33H as presented in the September 2021 was split into two paragraphs: A50 and A51]

A52A33I. ISA 300<sup>59</sup> requires the ~~group~~engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the group audit. The involvement of component auditors in

<sup>59</sup> ISA 300, paragraph 5

planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. ~~When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the audit.~~ The group engagement partner uses professional judgment in determining which component auditors to involve in planning the audit. This may be affected by the nature, timing and extent to which the component auditors are expected to be involved in designing and performing risk assessment or further audit procedures.

A53A33J. As described in ISQM 1,<sup>60</sup> there may be circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal or regulatory requirements. The level of fees, including their allocation to component auditors, and the extent to which they relate to the resources required may be a special consideration ~~by the firm~~ for group audit engagements. For example, in a group audit, the firm's financial and operational priorities may place constraints on the determination of the components at which audit work will be performed, as well as the resources needed, including the involvement of component auditors. In such circumstances, these constraints do not override the group engagement partner's responsibility for achieving quality at the engagement level or the requirements for the group auditor to obtain sufficient appropriate audit evidence on which to base the group audit opinion.

*Considerations When Component Auditors Are Involved (Ref: Para. 18–19)*

Sufficient and Appropriate Involvement in the Work of the Component Auditor (Ref: Para. 23–24)

A54A34. In evaluating whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor, the group auditor may obtain an understanding of whether the component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor. The group auditor may also obtain an understanding about whether audit evidence related to components located in a different jurisdiction may be in a different language and may need to be translated for use by the group auditor.

A55A35A. ~~If/When~~ the component auditor is unable to cooperate with the group auditor, the group auditor may:

- Request the component auditor to provide its rationale.
- Be able to take appropriate action to address the matter, including adjusting the nature of the work requested to be performed or in accordance with paragraph 27, not involving the component auditor in obtaining sufficient appropriate audit evidence relating to the work to be performed at the component ~~(in accordance with paragraph 22)~~.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: Para. 2520)

A56A36. When performing work at a component for a group audit engagement, the component auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit engagement. Such requirements may be different or in addition to those applying to the component auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for statutory, regulatory or other reasons in the component auditor's jurisdiction.

<sup>60</sup> ISQM 1, paragraph A74

A57A37. In making the component auditors aware of relevant ethical requirements, the group auditor may consider whether additional information or training for component auditors is necessary regarding the provisions of the ethical requirements that are relevant to the group audit engagement.

Engagement Resources (Ref: Para. 2624)

A58A40A. ISA 220 (Revised)<sup>61</sup> requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. When sufficient or appropriate resources are not made available in relation to work to be performed by a component auditor, the group engagement partner may discuss the matter with the component auditor, group management or the group auditor's firm and may subsequently request the component auditor or the group auditor's firm to make sufficient and appropriate resources available.

#### Competence and capabilities of the component auditors

A59A40B. ISA 220 (Revised)<sup>62</sup> provides guidance regarding matters the engagement partner may take into consideration~~account~~ when determining the competence and capabilities of the engagement team. This determination is particularly important in a group audit ~~when~~because the engagement team ~~may~~includes component auditors. ISA 220 (Revised)<sup>63</sup> indicates that the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether a component auditor~~or individual~~ from another firm has the appropriate competence and capabilities to perform the audit engagement. For example, as part of the confirmation required by paragraph 2419, the group auditor may ask the component auditor to confirm that the component auditor has the appropriate competence and capabilities, including sufficient time to perform the assigned audit procedures at the component.

#### ~~Competence and capabilities of the component auditors~~

A60A41. Determining whether component auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement. This determination influences the nature, timing and extent of the group engagement partner's direction and supervision of the component auditor and the review of their work.

A61A42. In determining whether component auditors have the appropriate competence and capabilities to perform the assigned~~necessary~~ audit procedures at the component ~~for purposes of the group audit~~, the group engagement partner may consider matters such as:

- Previous experience with or knowledge of the component auditor.
- The component auditor's specialized skills (e.g., industry-specific knowledge).
- The degree to which the group auditor and component auditor are subject to a common system of quality management, for example, whether the group auditor and a component auditor:
  - Use common resources to perform the work (e.g., audit methodologies or information

<sup>61</sup> ISA 220 (Revised), paragraph 25

<sup>62</sup> ISA 220 (Revised), paragraph A71

<sup>63</sup> ISA 220 (Revised), paragraph A24

technology (IT) applications);

- Share common policies or procedures affecting engagement performance (e.g., direction, ~~and~~ supervision and review of work or consultation);
- Are subject to common monitoring activities; or
- Have other commonalities, including common leadership or a common cultural environment.
- The consistency or similarity of:
  - Laws or regulations or legal system;
  - Language and culture;
  - Education and training;
  - Professional oversight, discipline, and external quality assurance; or
  - Professional organizations and standards.
- Information obtained about the component auditor through interactions with component management, those charged with governance, and other key personnel, such as internal auditors.

**A62A43.** The procedures to determine the component auditor's competency and capability may include, for example:

- An evaluation of the information communicated by the group auditor's firm to the group auditor, including:
  - The firm's ongoing communication related to monitoring and remediation, in circumstances when the group auditor and component auditor are from the same firm.<sup>64</sup>
  - Information from the network about the results of the monitoring activities undertaken by the network across the network firms.<sup>65</sup>
  - Information obtained from professional body(ies) to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.
- Discussing ~~the assessed risks of material misstatement~~ ~~the matters in paragraph A51~~ with the component auditor.
- Requesting the component auditor to confirm ~~their understanding of~~ the matters referred to in paragraph ~~2520~~ in writing.
- Discussing the component auditor's competence and capabilities with colleagues in the group engagement partner's firm that have worked directly with the component auditor.
- ~~● In subsequent years, requesting that the component auditor confirms whether anything in relation to the matters listed in paragraph 21(a)–(b) has changed since the previous year.~~
- Obtaining published external inspection reports.

<sup>64</sup> ISQM 1, paragraph 47

<sup>65</sup> ISQM 1, paragraph 51 ~~(b)~~

A63A44. The group engagement partner's firm and the component auditor's firm may be members of the same network and may be subject to common network requirements or use common networks services.<sup>66</sup> When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such network requirements, for example, those addressing professional training, or recruitment or that require the use of audit methodologies and related implementation tools. In accordance with ISQM 1,<sup>67</sup> the firm is responsible for designing, implementing and operating its system of quality management, and the firm may need to adapt or supplement network requirements or network services to be appropriate for use in its system of quality management.

Using the work of an auditor's expert

A64A44A. ~~When using the work of an auditor's expert, ISA 620<sup>68</sup> requires the auditor to evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In a group audit these evaluations include auditor's experts engaged by component auditors. ISA 220 (Revised)<sup>69</sup> requires the engagement partner to determine that members of the engagement team, and any auditor's external experts who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. When an auditor's expert is used by a component auditor, the group engagement partner may obtain information from the component auditor about the competence and capabilities of the auditor's expert.~~

Automated tools ~~and~~ techniques

A65A45. ~~As described in ISA 220 (Revised),<sup>70</sup> w~~When determining whether the engagement team has the appropriate competence and capabilities, the group engagement partner may take into consideration such matters as the expertise of the component auditor in the use of automated tools ~~and~~ techniques. ~~For example, as described in ISA 220 (Revised),<sup>71</sup> w~~When the group auditor requires component auditors to use specific automated tools and techniques when performing audit procedures, the group auditor may ~~include in communications~~ with component auditors that the use of such automated tools and techniques need to comply with the group auditor's instructions.

Application of the Group Auditor's Understanding of a Component Auditor (Ref: Para. 2722)

A66A46A. ISA 220 (Revised)<sup>72</sup> requires the engagement partner to take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures. This includes the firm's policies or procedures that address circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches. The firm's policies or procedures also may address breaches of

<sup>66</sup> ISQM 1, paragraphs A19, A175

<sup>67</sup> ISQM 1, paragraph 48–49

~~<sup>68</sup> ISA 620, Using the Work of an Auditor's Expert, paragraph 9~~

<sup>69</sup> ISA 220 (Revised), paragraph 26

~~<sup>70</sup> ISA 220 (Revised), paragraph A65~~

<sup>71</sup> ISA 220 (Revised), paragraph A65

<sup>72</sup> ISA 220 (Revised), paragraph 17

independence requirements by component auditors, and actions the group auditor may take in those circumstances in accordance with the relevant ethical requirements. In addition, relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances when breaches of independence requirements have been identified.<sup>73</sup>

A67A47. If ~~there has been a breach by~~ a component auditor ~~does not comply with~~ the relevant ethical requirements that ~~apply are relevant~~ to the group audit engagement, including those related to independence, ~~and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements,~~ the group auditor cannot ~~overcome the breach and continue to~~ use the work of ~~that~~ a component auditor by being involved in their work or by supplementing their work.

A68A48. Serious concerns are those concerns that in the group auditor's professional judgement cannot be overcome. The group engagement partner may be able to overcome less than serious concerns about the component auditor's professional competency (e.g., lack of industry-specific knowledge), or the fact that the component auditor does not operate in an environment that actively oversees auditors, by the group auditor being more involved in the work of the component auditor or by directly performing further audit procedures on the financial information of the component.

Engagement Performance (Ref: Para. 2823)

A69A48A. ISA 220 (Revised)<sup>74</sup> requires the engagement partner to determine that the nature, timing and extent of direction, supervision and review is planned and performed in accordance with the firm's policies or procedures, professional standards and applicable legal and regulatory requirements, and is responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team.<sup>75</sup> For a group audit, the approach to direction, supervision and review will generally include a combination of addressing the group auditor's firm policies or procedures and group audit engagement specific responses.

A70A49. ~~Paragraph 23 requires the group engagement partner to take responsibility for the nature, timing and extent of the direction and supervision of component auditors and the review of their work. As it may be not possible or practical for the group engagement partner to solely fulfill this requirement~~ For a group audit, particularly when the engagement team includes a large number of component auditors that may be located in multiple locations, the group engagement partner may assign the design or performance of procedures, tasks or actions to other members of the engagement team to assist the engagement partner in ~~complying with~~ fulfilling their requirement ~~responsibility for the nature, timing and extent of the direction and supervision of component auditors and the review of their work.~~ (see also paragraph 116).

A71A50. If component auditors are from a firm other than the group auditor's firm, the firm's policies or procedures may be different, or different actions may need to be taken, respectively, in relation to the nature, timing and extent of direction and supervision of those members of the engagement team, and the review of their work. In particular, firm policies or procedures may require the firm or the group engagement partner to take different actions from those applicable to members of the engagement team within the firm or the network (e.g., in relation to the form, content and timing of communications with component auditors, including the use of group auditor

<sup>73</sup> ISA 260 (Revised), paragraph A31

<sup>74</sup> ISA 220 (Revised), paragraph 30

<sup>75</sup> ~~ISA 220 (Revised), paragraph 30~~

instructions to component auditors). ISA 220 (Revised) provides examples of actions that may need to be taken in such circumstances.<sup>76</sup>

A72A51. The nature, timing and extent of direction and supervision of component auditors and review of their work may be tailored based on the nature and circumstances of the engagement and, for example:

- The assessed risks of material misstatement. For example, if the group auditor has identified a component that includes a significant risk, an increase in the extent of direction and supervision of the component auditor and a more detailed review of the component auditor's audit documentation may be appropriate.
- The competence and capabilities of the component auditors performing the audit work. For example, if the group auditor has no previous experience working with a component auditor, the group auditor may communicate more detailed instructions, increase the frequency of discussions or other interactions with the component auditor, or assign more experienced individuals to oversee the component auditor as the work is performed.
- The location of engagement team members, including the extent to which engagement team members are dispersed across multiple locations, including when ~~off~~ service delivery centers are used.
- Access to component auditor audit documentation. For example, when component auditor audit documentation cannot be transferred out of the jurisdiction, the group auditor may be able to review the audit documentation at the component auditor's location or remotely through the use of technology, when not prohibited by law or regulation (see also paragraphs A176A129–A177A130).

A73A52. There are different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work, for example:

- Communications with component auditors throughout the course of the group audit, including those required by this ISA:
- Meetings or calls with component auditors to ~~communicate about~~ discuss identified and assessed risks, issues, findings and conclusions.
- Reviews of the component auditor's audit documentation in person or remotely when permitted by law and regulation.
- Participating in the closing or other key meetings between the component auditors and component management.

A74A52x. ISA 220 (Revised)<sup>77</sup> also requires the engagement partner to review ~~specific~~ audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to:

- Significant matters;
- Significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
- Other matters that, in the engagement partner's professional judgment, are relevant to the

<sup>76</sup> ISA 220 (Revised), paragraph ~~A24~~–A25

<sup>77</sup> ISA 220 (Revised), paragraphs ~~31~~, A92–A93

engagement partner's responsibilities.

*Communications with Component Auditors* (Ref: Para. 2923A–23B)

A75A52A. Clear and timely communication between the group auditor and the component auditors about their respective responsibilities, along with clear direction to the component auditors about the nature, timing and extent of the work to be performed and the matters expected to be communicated to the group auditor, helps establish the basis for effective two-way communication. Effective two-way communication between the group auditor and the component auditors also helps to set expectations for component auditors and facilitates the group auditor's direction and supervision of them and the review of their work. Such communication also provides an opportunity for the group engagement partner to reinforce the need for component auditors to exercise professional skepticism in the work performed for purposes of the group audit.

A76A52B. Other factors that may also contribute to effective two-way communication include:

- Clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies or procedures of the group auditor's firm.
- A mutual understanding that the component auditor may ~~raise questions~~ wish to discuss about the audit work requested to be performed, based on the component auditor's knowledge and understanding of the component.
- A mutual understanding of relevant issues and the expected actions arising from the communication process.
- The form of communications. For example, ~~it may be better to discuss~~ matters that need timely attention may be more appropriately discussed in a meeting rather than by exchanging emails.
- A mutual understanding of the person(s) from the group auditor and component auditors who have responsibility for managing communications regarding particular matters.
- The process for the component auditor to take action and report back on matters communicated by the group auditor.

A77A52C. The communications between the group auditor and component auditors depend on the facts and circumstances of the group audit engagement, including the nature and extent of involvement of the component auditors and the degree to which the group auditor and component auditors are subject to common systems of quality management or common network requirements or network services.

Form of communications

A78A52D. The form of the communications between the group auditor and component auditors may vary based on factors such as the nature of the audit work the component auditors have been requested to perform, and the extent to which communication capabilities are integrated into the audit tools used for the group audit.

A79A52E. The form of communications also may be affected by such factors as:

- The significance, complexity or urgency of the matter.
- Whether the matter has been or is expected to be communicated to group management and those charged with governance of the group.

**A80A52F.** Communication between the group auditor and the component auditor may not necessarily be in writing. However, the group auditor’s verbal communications with the component auditors may be supplemented by written communication, such as a set of instructions regarding the work to be performed, when the group auditor wants to give particular attention to, or promote a mutual understanding about, certain matters. In addition, the group auditor may meet ~~in person~~ with the component auditor to discuss significant matters or to review relevant parts of the component auditor’s audit documentation.

**A81A52G.** Paragraph 4544 requires the group auditor to request the component auditor to communicate matters relevant to the group auditor’s conclusion with regard to the group audit. As explained in paragraph ~~A144A112A~~, the form and content of the component auditor’s deliverables are influenced by the nature and extent of the audit work the component auditor has been requested to perform.

**A82A52H.** Regardless of the form of communication, the documentation requirements of this and other ISAs apply.

Timing of communications ~~(Ref: Para. 23B)~~

**A83A52I.** The appropriate timing of communications will vary with the circumstances of the engagement. Relevant circumstances may include the nature, timing and extent of work to be performed by the component auditor and the action expected to be taken by the component auditor. For example, communications regarding planning matters may often be made early in the audit engagement and, for an initial group audit, may be made as part of agreeing the terms of the engagement.

Non-compliance with laws or regulations (Ref: Para. ~~2520~~, ~~2923A~~)

**A84A52J.** In applying ISA 250 (Revised),<sup>78</sup> the group engagement partner may become aware of information about non-compliance or suspected non-compliance with laws or regulations. In such circumstances, the group engagement partner may have an obligation under relevant ethical requirements, laws or regulations, to communicate the matter to the component auditor.<sup>79</sup> The obligation of the group engagement partner to communicate non-compliance or suspected non-compliance may extend to ~~components auditors of the financial statements of entities or business units that are not included in the scope of the group audit (e.g., components for which an audit is required by statute, regulation or for another reason, but for which no procedures are audit work is performed for purposes of the group audit).~~

### **Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group’s System of Internal Control (Ref: Para. ~~3024~~)**

**A85A53.** ISA 315 (Revised 2019)<sup>80</sup> contains requirements and guidance regarding the auditor’s responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity’s system of internal control.<sup>84</sup> Appendix ~~23~~ of this ISA provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how ISA

<sup>78</sup> ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*, ~~paragraphs 8–9~~

<sup>79</sup> See, for example, Section ~~R360.17~~ and Section ~~R360.18~~ of the *International Ethics Standards Board for Accountants’ International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code)

<sup>80</sup> ISA 315 (Revised 2019), paragraphs 19–27, A50–A183

<sup>84</sup> ~~ISA 315 (Revised 2019), paragraphs 19–27, A50–A183~~

~~315 (Revised 2019) is to be applied to an audit of group financial statements further explanation of the components of the system of internal control in the context of a group, including controls over the group's financial reporting process and the consolidation process.~~

~~A86A55.~~ The understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control may be obtained through communications with:

- Group management, component management or other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) and individuals who have knowledge of the group's system of internal control, accounting policies and practices, and the consolidation process;
- Component auditors; or
- Auditors that perform an audit for statutory, regulatory or ~~an~~ other reasons ~~on~~ of the financial statements of an entity or business unit that is part of the group.

~~A87A55A.~~ Obtaining an understanding of the group, identifying risks of material misstatement and assessing inherent risk and control risk may be performed in different ways depending on preferred audit techniques or methodologies and may be expressed in different ways. Accordingly, when component auditors are involved in the design and performance of risk assessment procedures, the group auditor may need to communicate its preferred approach with component auditors or provide instructions.

#### Engagement Team Discussion (Ref: Para. 30)

~~A88A55B.~~ In applying ISA 315 (Revised 2019),<sup>82</sup> the group engagement partner and other key engagement team members are required to discuss the application of the applicable financial reporting framework and the susceptibility of the ~~group~~ entity's financial statements to material misstatement. The group engagement partner's determination of which members of the engagement team to include in the discussions and the topics to be discussed, is affected by ~~matters~~ factors such as initial expectations about the risks of material misstatement and the preliminary expectation of ~~fn~~ whether to involve component auditors. [Previously paragraph A69 as presented in the September 2021 draft]

~~A89A55C.~~ The discussions provides an opportunity to:

- Share knowledge of the components and their environments, including which components' activities are centralized.
- Exchange information about the business risks of the components or the group, and how inherent risk factors may affect susceptibility to misstatement of classes of transactions, account balances and disclosures.
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. ~~For example,~~ ISA 240<sup>83</sup> requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur.<sup>84</sup>

<sup>82</sup> ISA 315 (Revised 2019), paragraph 17

<sup>83</sup> ~~ISA 240, paragraph 16~~

<sup>84</sup> ~~ISA 240, paragraph 16~~

- Identify policies followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting.
- Consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud.
- Consider the risk that group or component management may override controls.
- ~~• Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, where not, how differences in accounting policies are identified and adjusted (where required by the applicable financial reporting framework).~~
- Discuss fraud that has been identified, or information that indicates existence of a fraud.
- Identify risks of material misstatement relevant to components where the exercise of professional skepticism may be challenging particularly important.
- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if where not, how differences in accounting policies are identified and adjusted (where required by the applicable financial reporting framework).
- Share information about risks of material misstatement of the financial information of a component that may apply more broadly to some, or all, of the other components.
- Share information that may indicate non-compliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices.
- Discuss events or conditions identified by group management, component management or the engagement team, that may cast significant doubt on the group's ability to continue as a going concern.
- Discuss related party relationships or transactions identified by group management or component management, and any other related parties of which the engagement team is aware. [Previously paragraph A70 as presented in the September 2021 draft]

*The Group and Its Environment* (Ref: Para. 30-24(a))

A90A56. An understanding of the group's organizational structure and its business model may enable the group auditor to understand such matters as:

- The complexity of the group's structure. A group may be more complex than a single entity because a group may have several subsidiaries, divisions or other business units, including in multiple locations. Also, a group's legal structure may be different from the operating structure, for example, for tax purposes. Complex structures often introduce factors that may give rise to increased susceptibility to material misstatements, such as whether goodwill, joint ventures or special purpose entities are accounted for appropriately and whether adequate disclosures have been made.
- The geographic locations of the group's operations. Having a group that is located in multiple geographical locations may give rise to increased susceptibility to material misstatements. For example, different geographical locations may involve different

languages, cultures and business practices.

- The structure and complexity of the group's IT environment. A complex IT environment often introduces factors that may give rise to increased susceptibility to material misstatements. For example, a group may have a complex IT environment because of multiple IT systems that are not integrated due to recent acquisitions or mergers. Therefore, it may be particularly important to obtain an understanding of the complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment. A group may also use one or more external service providers for aspects of its IT environment.
- Relevant regulatory factors, including the regulatory environment. Different laws or regulations may introduce factors that may give rise to increased susceptibility to material misstatements. A group may have operations that are subject to a high degree of complex laws or regulations in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.
- The ownership, and relationships between owners and other people or entities, including related parties. Understanding the ownership and relationships can be more complex in a group that operates ~~acrossover~~ multiple jurisdictions and when there are changes in ownership through formation, acquisition, disposals or joint ventures. These factors may give rise to increased susceptibility to material misstatements.

A91A57. Obtaining an understanding of the degree to which the group's operations or activities are similar may ~~enable the group auditor help~~ to identify similar risks of material misstatement across components and design an appropriate response.

A92A58. The financial results of entities or business units are ordinarily measured and reviewed by group management. Inquiries of group management may reveal that group management relies on certain key indicators to evaluate the financial performance of the group's entities and business units and take action. The ~~group auditor's~~ understanding of such performance measures may help to identify:

- Areas where there is increased susceptibility to ~~the risk of~~ material misstatements (e.g., due to pressures on component management to meet certain performance measures).
- Controls over the group's financial reporting process.

### *The Group's System of Internal Control*

The Nature and Extent of Commonality of Controls (Ref: Para. 3024(c)(i))

A93A59. Group management may design controls that are intended to operate in a common manner across multiple entities or business units (i.e., common controls). For example, group management may design common controls for inventory management, ~~which that~~ operate using the same IT system and that are implemented across all entities or business units in the group. Common controls may exist in each component of the group's system of internal control, and they may be implemented at different levels within the group (e.g., at the level of the consolidated group as a whole, or for other levels of aggregation within the group). Common controls may be direct controls or indirect controls. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that support direct controls.<sup>85</sup>

<sup>85</sup> ISA 315 (Revised 2019), paragraph A5

A94A60. ~~U~~The understanding ~~of~~ the components of the group's system of internal control ~~therefore~~ includes understanding the commonality of the controls within those components across the group. ~~That understanding may help the group auditor to identify, assess and appropriately respond to the assessed risks of material misstatement. When the group auditor plans to test the operating effectiveness of identified controls<sup>86</sup> that are common across the group, the group auditor evaluates the design and determines the implementation of those controls in accordance with ISA 315 (Revised 2019).~~

A95A61. ~~In~~To ~~understand~~determine the commonality of an ~~identified~~ control across the group, considerations that may be relevant include~~the group auditor may consider~~ whether:

- The control is designed centrally and is required to be implemented as designed (i.e., without modification) at some or all components;
- The control is implemented and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components where the control is implemented;
- If a control uses information from IT applications, the IT applications and other aspects of the IT environment that generate the information are the same across the components or locations; or
- If the control is automated, it is configured in the same way in each IT application across the components.

A96A62. Judgment may often be needed to determine whether an ~~identified~~ control is a common control. For example, group management may require that all entities and business units perform a monthly evaluation of the aging of customers' accounts that are generated from a specific IT application. When the aging reports are generated from different IT applications or the implementation of the IT application differs across entities or business units, ~~the~~group auditor may be a need to consider whether the control can ~~still~~ be determined to be common. This is because of differences in the design of the control that may exist due to the existence of different IT applications (e.g., whether the IT application is configured in the same manner across components, and whether there are effective general IT controls across different IT applications).

A97A63. Consideration of the level at which controls are performed within the group (e.g., at the level of the consolidated group as a whole or for other levels of aggregation within the group) and the degree of centralization and commonality may be important to the understanding of how information is processed and controlled. In some circumstances, controls may be performed centrally (e.g., performed only at a single entity or business unit), but may have a pervasive effect on other entities or business units (e.g., a shared ~~services~~service center that processes transactions on behalf of other entities or business units within the group). The processing of transactions and related controls at a shared service center may operate in the same way for those transactions being processed by the shared service center regardless of the entity or business unit (e.g., the processes, risks, and controls may be the same regardless of the source of the transaction). In such cases, it may be appropriate to identify the controls and evaluate the design and determine the implementation of the controls, and, if applicable, test operating effectiveness, as a single population.

<sup>86</sup> ISA 315 (Revised 2019), paragraphs 26(a) and 26(c)(ii)

Centralized Activities (Ref: Para. 3024(c)(i)-(ii))

A98A64. Group management may centralize some of its activities, for example financial reporting or accounting functions may be performed for a particular group of common transactions or other financial information in a consistent and centralized manner for multiple entities or business units (e.g., when ~~the~~ the initiation, authorization, recording, processing, or reporting of revenue transactions is performed at a shared service center).

A99A65. Obtaining an understanding of how centralized activities fit into the overall group structure, and the nature of the activities undertaken, may help ~~the group auditor~~ to identify and assess risks of material misstatement and appropriately respond to such risks. For example, controls at a shared service center may operate independently from other controls, or they may be dependent upon controls at an entity or business unit from which financial information is derived (e.g., sales transactions may be initiated and authorized at an entity or business unit component, but the processing may occur at the shared service center).

A100A65A. The group auditor may involve component auditors in testing the operating effectiveness of common controls or controls related to centralized activities. In such circumstances, effective collaboration between the group auditor and component auditors is important as the audit evidence obtained through testing the operating effectiveness of common controls or controls related to centralized activities supports the ~~group auditor's~~ determination of the nature, timing and extent of substantive procedures to be performed across the group.

Communications About Significant Matters that Support the Preparation of the Group Financial Statements (Ref: Para. 3024(c)(iv))

A101A66. Group entities or business units may use a financial reporting framework for statutory, regulatory or ~~another reasons~~ that is different from the financial reporting framework used for the group's financial statements. In such circumstances, an understanding of group management's financial reporting processes to align accounting policies and, when ~~the~~ relevant, financial reporting period-ends that differ from that of the group, enables the group auditor to understand how adjustments, reconciliations and reclassifications are made, and whether they are made centrally by group management or by the entity or business unit.

## Instructions by group management to entities or business units

A102A67. In applying ISA 315 (Revised 2019),<sup>87</sup> the group auditor is required to understand how group management communicates significant matters that support the preparation of the group financial statements. To achieve uniformity and comparability of financial information, group management may issue instructions (e.g., communicate financial reporting policies) to the entities or business units that include details about financial reporting processes or may have policies that are common across the group. Obtaining an understanding of group management's instructions may affect the ~~group auditor's~~ identification and assessment of the risks of material misstatement of the group financial statements. For example, ~~in certain circumstances,~~ inadequate instructions may increase the likelihood of misstatements due to the risk that transactions are incorrectly recorded or processed, or that accounting policies are incorrectly applied.

<sup>87</sup> ISA 315 (Revised 2019), paragraph 25(b)

A103A68. The group auditor's understanding of the instructions or policies may include the following:

- The clarity and practicality of the instructions for completing the reporting package.
- Whether the instructions:
  - Adequately describe the characteristics of the applicable financial reporting framework and the accounting policies to be applied;
  - Address information necessary to prepare disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example, disclosure of related party relationships and transactions, and segment information;
  - Address information necessary for making consolidation adjustments, for example, intra-group transactions and unrealized profits, and intra-group account balances; and
  - Include a reporting timetable.

~~Engagement Team Discussions (Ref: Para. 24)~~

[Paragraph A69 as presented in the September 2021 draft is now paragraph A88]

[Paragraph A70 as presented in the September 2021 draft is now paragraph A89]

*Considerations When Component Auditors Are Involved* (Ref: Para. ~~3126~~ 3226A)

A104A72A. ~~During the course of the group audit, t~~The group auditor may communicate the matters in paragraph ~~3126A~~ to other component auditors, if these matters are relevant to the work of those component auditors. ~~Matters communicated, including those in paragraph 26A may be communicated in the course of the component auditor's work. For example, the matters included in p~~Paragraph ~~A142A111A~~ A142A111A includes examples of other matters that may need to be communicated timely in the course of the component auditor's work.

A105A72. The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.<sup>88</sup> In a group audit there may be a higher risk of material misstatement of the group financial statements, including due to fraud, associated with related party relationships when:

- The group structure is complex;
- The group's information systems are not integrated and therefore less effective in identifying and recording related party relationships and transactions; and
- There are numerous or frequent related party transactions between entities and business units.

Planning and performing the audit with professional skepticism, as required by ISA 200,<sup>89</sup> is therefore particularly important when these circumstances exist.

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<sup>88</sup> ISA 550, paragraph 2

<sup>89</sup> ISA 200, paragraphs ~~15 and A53~~

**Identifying and Assessing the Risks of Material Misstatement** (Ref: Para. ~~3426B~~)

~~A106A72B~~. The process to identify and assess the risks of material misstatement of the group financial statements is ~~cumulative and~~ iterative and dynamic, and may be challenging, particularly when the component's activities are complex or specialized, or when there are many components across multiple locations. In applying ISA 315 (Revised 2019),<sup>90</sup> the auditor develops initial expectations about the potential risks of material misstatement and an initial identification of the significant classes of transactions, account balances and disclosures of the group financial statements based on their understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control.

~~A107A72C~~. The initial expectations about the potential risks of material misstatement take into account the auditor's understanding of the group, including its entities or business units, and the environments and industries in which they operate. Based on the initial expectations, the group auditor may, and often will, involve component auditors in risk assessment procedures as they may have direct knowledge and experience with the entities or business units that may be helpful in understanding the activities and related risks, and where risks of material misstatement of the group financial statements may arise in relation to those entities or business units.

~~A108A72D~~. ~~Identifying risks of material misstatement, including those communicated by component auditors, provides the basis for the group auditor's determination of relevant assertions, which assists the group auditor's determination of the significant classes of transactions, account balances and disclosures of the group financial statements.~~ The group auditor is required to take responsibility for assessing ~~the~~ inherent risk. Such assessment involves ~~of the identified risks of material misstatements by~~ assessing the likelihood and magnitude of misstatement, which takes ~~ing~~ into account:<sup>91</sup>

- ~~the~~ inherent risk factors affecting the susceptibility of relevant assertions to misstatement.<sup>92</sup>
- How the risk of material misstatement at the group financial statement level affect the assessment of inherent risk. ~~The group auditor's process (or the process of component auditors to whom risk assessment procedures are assigned) of assessing the identified risks of material misstatement at the assertion level also includes the determination of significant risks.~~

~~A109A72E~~. Based on the risk assessment procedures performed, the group auditor may determine that an assessed risk of material misstatement of the group financial statements only arises in relation to financial information of certain components. For example, the risk of material misstatement relating to a legal claim may only exist in entities or business units that operate in a certain jurisdiction or in entities or business units that have similar operations or activities.

~~A110A72F~~. Appendix 34 sets out examples of events and conditions that, individually or together, may indicate risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process.

<sup>90</sup> ISA 315 (Revised 2019), paragraphs ~~25–26~~ A126

<sup>91</sup> ISA 315 (Revised 2019), paragraph 31

<sup>92</sup> ~~ISA 315 (Revised 2019), paragraph 34~~

*Fraud*

**A111A72G**. In applying ISA 240,<sup>93</sup> the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are implement-appropriate-responsivees to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risks that the group financial statements may beare materially misstated due toas a result of fraud.
- Group management's process for identifying and responding to the risks of fraud in the group financial statements, including any specific fraud risks identified by group management, or classes of transactions, account balances, or disclosures for which a risk of fraud is higher.
- Whether there are particular components for which are more susceptible to the risks of material misstatement due to fraud is higher.
- Whether any fraud risk factors or indicators of management bias exist in the consolidation process.
- How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.
- Responses of those charged with governance of the group, group management, appropriate individuals within the internal audit function (and whenif-considered appropriate, component management, the component auditors, and others) to the group auditor's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.

*Considerations When Component Auditors Are Involved* (Ref: Para. 3426G)

**A112A72H**. When the group auditor involves component auditors in the design and performance of risk assessment procedures, the group auditor remains responsible for having an understanding of the group and its environment, the applicable financial reporting framework and the group's system of internal control to have a sufficient basis for the identification and assessment of the risks of material misstatement of the group financial statements in accordance with paragraph 3326B.

**A113A72I**. When the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement, ISA 315 (Revised 2019)<sup>94</sup> requires the group-auditor to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

<sup>93</sup> ISA 240, paragraphs 26, ~~29~~-31

<sup>94</sup> ISA 315 (Revised 2019), paragraph 35

## Materiality

*Component Performance Materiality* (Ref: Para. [3529\(a\)](#))

[A114A73](#). Paragraph [3529\(a\)](#) requires the group auditor to determine component performance materiality for each of the components where audit procedures are performed on financial information that is disaggregated. The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.

[A115A74](#). This ISA does not require component performance materiality to be determined for each class of transactions, account balance or disclosure for components at which audit procedures are performed. However, if, in the specific circumstances of the group, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, ISA 320<sup>95</sup> requires ~~the auditor to determine determination of~~ the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.<sup>96</sup> In these circumstances, the group auditor may need to consider whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate for those particular classes of transactions, account balances or disclosures.<sup>97</sup>

[A116A75](#). The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the group auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (e.g., as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (e.g., if a single component represents a large portion of the group, there likely may be less disaggregation across components).
- Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example:
  - Whether there are risks that are unique to the financial information of the component (e.g., industry-specific accounting matters, unusual or complex transactions).
  - The nature and extent of misstatements identified at the component in prior audits.

[A117A75A](#). To address aggregation risk, paragraph [3529\(a\)](#) requires component performance materiality to be lower than group performance materiality. As explained in paragraph [A116A75](#), as the extent of disaggregation across components increases, a lower component performance materiality amount ordinarily would be appropriate to address aggregation risk. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality because there is less aggregation risk, such as when the financial information for one component represents a substantial portion of the group financial statements.

<sup>95</sup> [ISA 320, paragraph A13](#)

<sup>96</sup> [ISA 320, paragraphs 10 and A11–A12](#)

<sup>97</sup> ~~[ISA 320, paragraph A13](#)~~

**A118A76.** In some cases, further audit procedures may be performed by the group auditor or a component auditor on a significant class of transactions or significant account balance as a single population (i.e., not disaggregated across components). In such cases, group performance materiality often will be used for purposes of performing these procedures.

*'Clearly Trivial' Threshold* (Ref: Para: [3529\(b\)](#))

**A119A77.** The threshold for communicating misstatements to the group auditor is set at an amount equal to, or lower than, the amount regarded as clearly trivial for the group financial statements. In accordance with ISA 450,<sup>98</sup> this threshold is the amount below which misstatements would not need to be accumulated because the group auditor expects that the accumulation of such amounts clearly would not have a material effect on the group financial statements.

#### *Considerations When Component Auditors Are Involved*

Communicating Component Performance Materiality (Ref: Para. [3637](#))

**A120A77A.** In some cases, it may be appropriate for the group auditor to involve the component auditor in determining an appropriate component performance materiality amount, in view of the component auditor's in-depth knowledge of the component and potential sources of misstatement of the component financial information. In this regard, the group auditor also may consider communicating group performance materiality to the component auditor to support collaboration in determining whether component performance materiality, in relation to group performance materiality, is appropriate in the circumstances.

**A121A77B.** Component performance materiality is based, at least in part, on expectations about the nature, frequency, and magnitude of misstatements in the component financial information. Therefore, ongoing communication between the component auditor and the group auditor is important, particularly if the number and magnitude of misstatements identified by the component auditor are higher than expected.

#### **Responding to the Assessed Risks of Material Misstatement** (Ref: Para. [3733](#))

##### *Performing Further Audit Procedures*

##### Performing Further Audit Procedures Centrally

**A122A86.** ~~Further audit procedures may be designed and performed~~~~The group auditor may design and perform further audit procedures~~ centrally if the audit evidence to be obtained from performing further audit procedures on one or more **significant** classes of transactions, account balances or disclosures in the aggregate will respond to the assessed risks of material misstatement. ~~f.~~ For example, if the accounting records for the revenue transactions of the entire group are maintained centrally (e.g., at a shared service center), ~~the group auditor may perform further audit procedures to address the assessed risks of material misstatement of the related classes of transactions, account balances, and disclosures.~~ Factors that may be relevant to the auditor's determination of whether to perform further audit procedures centrally include, for example:

- The level of centralization of activities relevant to financial reporting.
- The nature and extent of commonality of controls.
- The similarity of the group's activities and business lines.

**A123A88.** The group auditor may determine that the financial information of several components can

<sup>98</sup> ISA 450, paragraph A3

be considered as one population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogenous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way.

A124A88A. When further audit procedures are performed centrally, component auditors may still be involved. For example, when the group has multiple shared service centers, the group auditor may involve component auditors in the performance of further audit procedures for these shared service centers.

#### Performing Further Audit Procedures at the Component Level

A125A88B. In other circumstances, procedures to respond to the risks of material misstatement ~~of at~~ the group financial statements ~~s-level~~ that are related to the financial information of a component may be more effectively performed at the component level. This may be the case when the group has:

- Different revenue streams;
- Multiple lines of business;
- Operations across multiple locations; or
- Decentralized systems of internal control.

#### Large Number of Components Whose Financial Information Is Individually Immaterial but Material in the Aggregate to the Group Financial Statements

A126A89. A group may be comprised of a large number of components whose financial information is individually immaterial but material in the aggregate to the group financial statements. ~~These circumstances~~ Circumstances such as these in which may present additional challenges for the group auditor in planning and performing further audit procedures for the significant classes of transactions, account balances or disclosures in the group financial statements are disaggregated over a large number of components may present additional challenges for the group auditor in planning and performing further audit procedures.

A127A89AA. In some cases, it may be possible to obtain sufficient appropriate audit evidence by performing further audit procedures centrally on these significant classes of transactions, account balances or disclosures (e.g., if they are homogeneous, subject to common controls and access to appropriate information can be obtained). The further audit procedures may also include substantive analytical procedures in accordance with ISA 520.<sup>99</sup> Depending on the circumstances of the engagement, the financial information of the components may be aggregated at appropriate levels for purposes of developing expectations and determining the amount of any difference of recorded amounts from expected values in performing the substantive analytical procedures. The use of automated tools and techniques may be helpful in these circumstances.

A128A89A. In other cases, it may be necessary to perform further audit procedures at selected components to address the risks of material misstatement of the group financial statements. The determination of the components at which audit procedures are to be performed, and the nature, timing and extent of further audit procedures to be performed at the selected components, are matters of professional judgment. In these circumstances, introducing an element of unpredictability in the components selected for testing also may be helpful in relation to the risks

<sup>99</sup> ISA 520, *Analytical Procedures*

of material misstatement of the group financial statements due to fraud (also see paragraph [A134A94](#)).

#### *The Nature and Extent of Further Audit Procedures*

~~A129A90A. In determining the nature and extent of further audit procedures to be performed at a component,~~ the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):

- Design and perform further audit procedures on the entire financial information of the component;
- Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures; or
- Perform specific further audit procedures.

~~A130A90B. Although the group auditor takes responsibility for the nature, timing and extent of further audit procedures to be performed, component auditors can be, and often are, involved in all phases of the group audit, including in the design and performance of further audit procedures.~~

#### *Design and Perform Further Audit Procedures on the Entire Financial Information of the Component*

~~A131A90C. The group auditor may determine that designing and performing further audit procedures on the entire financial information of a component is an appropriate approach, including when:~~

- Audit evidence needs to be obtained on all or a significant proportion of a component's financial information to respond to the assessed risks of material misstatement of the group financial statements.
- There is a pervasive risk of material misstatement of the group financial statements due to the existence of events or conditions at the component that may be relevant to the group auditor's evaluation of group management's assessment of the group's ability to continue as a going concern.

#### *Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures*

~~A132A90D. The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address an assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but holds a significant portion of the land and buildings of the group or has significant tax balances.~~

#### *Perform specific further audit procedures*

~~A133A90E. The group auditor may determine that designing and performing specific further audit procedures on the financial information of a component is an appropriate approach, such as when audit evidence needs to be obtained for specific assertions only. For example, the group auditor may centrally test the class of transaction, account balance or disclosure and may require the component auditor to perform specific further audit procedures at the component (e.g., specific further audit procedures related to the valuation of claims or litigations in the component's jurisdiction or the existence of an asset).~~

*Element of Unpredictability*

A134A91. Incorporating ~~luding~~ an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed and the extent to which the group auditor is involved in the work, may increase the likelihood of identifying a material misstatement of the components' financial information that may give rise to a material misstatement of the group financial statements due to fraud.<sup>100</sup>

*Operating Effectiveness of Controls That Are Common Across the Group*

A135A92. ~~If~~ The group auditor ~~may intends to~~ rely on the operating effectiveness of controls that operate throughout the group in determining the nature, timing and extent of substantive procedures to be performed at either the group level or at the components, ~~the group auditor, in accordance with~~ ISA 330,<sup>101</sup> ~~is required to the auditor to~~ design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of those controls. ~~This includes the group auditor may request the~~ component auditors ~~may be involved to assist the group auditor~~ in performing ~~such tests of control~~ these procedures.

A136A93. If deviations from controls upon which the auditor intends to rely are detected, ISA 330<sup>102</sup> requires the auditor to make specific inquiries to understand these matters and their potential consequences. If more deviations than expected are detected as a result of testing the operating effectiveness of the controls, the group auditor may need to revise the group audit plan. Possible revisions to the group audit plan may include:

- Requesting additional substantive procedures to be performed at certain components.
- Identifying and testing the operating effectiveness of other relevant controls that are designed and implemented effectively.
- Increasing the number of components selected for further audit procedures.

A137A93A. When the operating effectiveness of controls is tested centrally (e.g., controls at a shared service center or testing of common controls), the group auditor may need to communicate information about the audit work performed to the component auditors. For example, when a component auditor is requested to design and perform substantive ~~audit~~ procedures on the entire financial information of the component, or design and perform substantive ~~audit~~ procedures on one or more classes of transactions, account balances or disclosures, the component auditor may ~~discusse~~ communicate with the group auditor about the control testing performed centrally to determine the nature, timing and extent of the substantive procedures.

*Consolidation Process*

Consolidation Procedures (Ref: Para. 3834(a))

A138A94. The further audit procedures on the consolidation, including sub-consolidations, may include:

- Determining that the journal entries necessary are reflected in the consolidation; and
- Evaluating the operating effectiveness of the controls over the consolidation process and responding appropriately if any controls are determined to be ineffective.

<sup>100</sup> ISA 240, paragraph 30(c)

<sup>101</sup> ISA 330, paragraph 8

<sup>102</sup> ISA 330, paragraph 17

Consolidation Adjustments and Reclassifications (Ref: Para. ~~3834~~(c))

~~A139A95~~. The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements that do not pass through the usual IT applications, and may not be subject to the same controls to which other financial information is subject. The group auditor's evaluation of the appropriateness, completeness and accuracy of the adjustments and reclassifications may include:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;
- Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included;
- Determining whether significant adjustments have been correctly calculated, processed and authorized by group management and, ~~when~~ applicable, by component management;
- Determining whether significant adjustments are properly supported and sufficiently documented; and
- Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits, and intra-group account balances.

*Considerations When Component Auditors Are Involved* (Ref: Para. ~~4238–4339~~)

~~A140A95A~~. ~~When experts are involved in performing further audit procedures, ISA 620<sup>103</sup> requires the auditor to evaluate the adequacy of the auditor's expert's work for the auditor's purposes. In a group audit these evaluations include the work of auditor's experts engaged by component auditors. When the group auditor involves component auditors in the design or performance of further audit procedures, the component auditor may determine that the use of the work of an auditor's expert is appropriate and communicate this to the group auditor. In such circumstances, when determining that the component auditor's design and performance of further audit procedures is appropriate, the group auditor may, for example, discuss with the component auditor the nature, scope and objectives of the auditor's expert's work or the component auditor's evaluation of the adequacy of the work of the auditor's expert for the group auditor's purposes.~~

~~A141A102~~. The appropriate level of the group auditor's involvement may depend on the circumstances and the structure of the group and other factors, such as the group auditor's previous experience with the component auditors that perform procedures on the consolidation and sub-consolidations (~~also see paragraphs A42 and A51~~) and the circumstances of the group audit engagement (e.g., if the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements).

**Evaluating the Component Auditor's Communication and the Adequacy of Their Work**  
**Communication about Matters Relevant to the Group Auditor's Conclusion**

*Communication about Matters Relevant to the Group Auditor's Conclusion with Regard to the Group Audit* (Ref: Para. ~~4544~~)

~~A142A111A~~. Although the matters required to be communicated in accordance with paragraph ~~4544~~ are relevant to the group auditor's conclusion with regard to the group audit, certain matters may ~~need to be~~ communicated ~~timely in during~~ the course of the component auditor's procedures. In

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<sup>103</sup>—ISA 620, paragraph 12

addition to the matters in paragraphs ~~3226A~~ and ~~5048~~, such matters may include, for example:

- Information ~~on~~ about breaches of relevant ethical requirements, including identified breaches of independence provisions;
- Information ~~on~~ about instances of non-compliance with laws or regulations;
- Newly arising significant risks of material misstatement, including risks of fraud;
- Identified or suspected fraud or illegal acts involving component management or employees that could have a material effect on the group financial statements; or
- Significant and unusual transactions.

*Communication of Misstatements of Component Financial Information* (Ref: Para. ~~45(e)44(e)~~)

~~A143A111B~~. Knowledge about corrected and uncorrected misstatements across components may alert the group auditor to potential pervasive internal control deficiencies, when considered along with the communication of deficiencies in accordance with paragraph ~~45(g)44(e)~~. In addition, a higher than expected number of identified misstatements (uncorrected or corrected) may indicate a higher risk of undetected misstatements, which may lead the group auditor to conclude that additional audit procedures need to be performed at certain components.

*Component Auditor's Overall Findings or Conclusions* (Ref: Para. ~~45(k)44(h)~~)

~~A144A112A~~. The form and content of the deliverables from the component auditor are influenced by the nature and extent of the audit work the component auditor has been requested to perform. The group auditor's firm policies or procedures may address the form or specific wording of an overall conclusion statement from the component auditor on the audit work performed for purposes of the group audit.

*Reviewing Additional Component Auditor Audit Documentation* (Ref: Para. ~~4745A~~)

~~A112xAs explained in paragraphs A48A and A52x, the group engagement partner is required to determine that the nature, timing and extent of direction, supervision and review of component auditors and the review of their work are appropriate given the nature and circumstances of the group audit engagement, and to review specific audit documentation for the group audit.~~

~~A145A112B~~. Paragraph ~~A72A51~~ provides guidance for the group auditor in tailoring the nature, timing and extent of the direction and supervision of the component auditor, and the review of their work, ~~to be based on~~ the facts and circumstances of the group audit and other matters (e.g., the assessed risks of material misstatement of the group financial statements). The group auditor's consideration in accordance with determination required by paragraph 47(c)45A may be affected by the matters in paragraph A72, as well as the following matters relevant to the group auditor's ongoing involvement in the work of the component auditor: ~~relates to whether there is a need for the group auditor to review additional component auditor audit documentation, taking into account:~~

~~— The group auditor's ongoing direction and supervision of the work performed by the component auditor;~~

- Communications from the component auditor, including those in accordance with paragraph 4544 of this ISA; and

~~— The review of component auditor audit documentation by the group auditor during the course of the group audit (e.g., to fulfill the requirements of paragraphs 34, 42 and 43) or~~

~~by the group engagement partner in accordance with paragraph 31 of ISA 220 (Revised), and~~

- ~~• Communications from the component auditor, including those in accordance with paragraph 44 of this ISA.~~

~~A146A113. Paragraph A51 provides guidance for the group auditor in tailoring the nature, timing and extent of the direction and supervision of the component auditor, and the review of their work, to the facts and circumstances of the group audit.~~ Other factors that may affect the group auditor's determination about whether, and the extent to which, it is necessary to review additional component auditor audit documentation in the circumstances include:

- The degree to which the component auditor was involved in risk assessment procedures and in the identification and assessment of the risks of material misstatement of the group financial statements;
- The significant judgments made by, and the findings or conclusions of, the component auditor about matters that are material to the group financial statements;
- The competence and capabilities of more experienced engagement team members from the component auditor firm responsible for reviewing the work of less experienced individuals; and
- Whether the component auditor and group auditor are subject to common policies or procedures for review of audit documentation.

#### **Subsequent Events** (Ref: Para. ~~49–5047~~)

~~A147A1114.~~ The group auditor may:

- Request a component auditor to perform subsequent events procedures to assist the group auditor to identify events that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements.
- Perform procedures to cover the period between the date of communication of subsequent events by the component auditor and the date of the auditor's report on the group financial statements.

#### **Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

*Sufficiency and Appropriateness of Audit Evidence* (Ref: Para. ~~5149~~)

~~A148A114A.~~ The audit of group financial statements is a cumulative and iterative process. As the group auditor performs planned audit procedures, the audit evidence obtained may cause the group auditor to modify the nature, timing or extent of other planned audit procedures as information may come to the group auditor's attention that differs significantly from the information on which the risk assessment was based. For example:

- The misstatements identified at a component may need to be considered in relation to other components; or
- The group auditor may become aware of access restrictions to information or people at a component because of changes in the environment (e.g., war, civil unrest or outbreaks of disease).

In such circumstances, the group auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the significant classes of

transactions, account balances, or disclosures and related assertions.

A149A115. The evaluation required by paragraph 51~~49~~ assists the group auditor in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in ISA 330<sup>104</sup> for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each material class of transactions, account balance, ~~class of transactions~~ and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.

A150A115A. The group auditor may ~~further~~ consider ~~matters that may affect~~ the engagement team's exercise of professional skepticism ~~in a group audit, such as those described in paragraph A9A~~, when evaluating the sufficiency and appropriateness of audit evidence obtained. ~~In particular~~ For example, the group auditor may consider whether ~~such~~ matters such as those described in paragraph A16A9A have inappropriately led the engagement team to:

- Obtain audit evidence that is easier to access without giving appropriate consideration to its rather than obtain evidence that is more relevant relevance and reliable reliability;
- Obtain less persuasive evidence than is necessary in the circumstances; or
- Design and perform audit procedures in a manner that is biased towards obtaining evidence that is corroborative or excluding evidence that is contradictory.

A151A115B. ISA 220 (Revised)<sup>105</sup> requires the engagement partner to determine, on or before the date of the auditor's report, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.<sup>106</sup> Information that may be relevant to the group auditor's evaluation of the audit evidence obtained from the work performed by component auditors depends on the facts and circumstances of the group audit, and may include:

- The communications from the component auditors required by paragraph 4~~5~~44, including the overall findings or conclusions of the component auditors on the work performed for purposes of the group audit;
- Other communications from the component auditors throughout the group audit, including those required by paragraph 3226A; and
- The group auditor's direction and supervision of the component auditors, and review of their work, including, as applicable, the group auditor's review of ~~the additional~~ component auditor's audit documentation in accordance with paragraph 4745A.

A152A115C. In some circumstances, an overall summary memorandum describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.

*~~Evaluating the Effect on the Group Audit Opinion (Ref: Para. 50)~~*

<sup>104</sup> ISA 330, paragraph 18

<sup>105</sup> ISA 220 (Revised), paragraph 32

<sup>106</sup> ~~ISA 220 (Revised), paragraph 32~~

**A153A116.** The group engagement partner's evaluation may include a consideration of whether corrected and uncorrected misstatements communicated by component auditors indicate a systemic issue (e.g., regarding transactions subject to common accounting policies or common controls) that may affect other components.

## Auditor's Report

*Auditor's Report* (Ref: Para: [5352](#))

**A154A117.** Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings or conclusions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.

**A155A118.** When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Qualified Opinion or Basis for Disclaimer of Opinion section in the auditor's report on the group financial statements describes the reasons for that inability.<sup>107</sup> In some circumstances, a reference to a component auditor may be necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.

## Communication with Group Management and Those Charged with Governance of the Group

*Communication with Group Management* (Ref: Para. [5453A–5655](#))

**A156A119A.** The group audit ~~plan~~ may be complex due to the number and nature of the entities and business units comprising the group. In addition, as explained in paragraph [A75](#), the group auditor may determine that certain entities or business units may be considered together as a component for purposes of planning and performing the group audit. Therefore, discussing with group management an overview of the ~~planned scope and timing group auditor plan~~ may help in coordinating the work performed at components, including when component auditors are involved, and in identifying component management (see paragraph [A22A15](#)).

**A157A120.** ISA 240<sup>108</sup> contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.<sup>109</sup>

**A158A121.** Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:

- Potential litigation.
- Plans for abandonment of material operating assets.
- Subsequent events.
- Significant legal agreements.

<sup>107</sup> ISA 705 (Revised), paragraphs 20 and 24

<sup>108</sup> ~~ISA 240, paragraphs 41–43~~

<sup>109</sup> ~~ISA 240, paragraphs 41–43~~

A159. Group management may inform the group auditor about non-compliance or suspected non-compliance with laws or regulations in entities or business units within the group. Paragraph A84 provides guidance for the group engagement partner in these circumstances.

*Communication with Those Charged with Governance of the Group* (Ref: Para. 5756)

A160A122. The matters the group auditor communicates to those charged with governance of the group may include those brought to the attention of the group auditor by component auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group may take place at various times during the group audit. For example, the matter referred to in paragraph 5756(a) may be communicated after the group auditor has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph 5756(b) may be communicated at the end of the audit, and the matters referred to in paragraph 5756(c)–(d) may be communicated when they occur.

A161A123. ISA 260 (Revised)<sup>110</sup> requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. For a group audit, this communication helps those charged with governance understand the group auditor's determination of the components at which audit work will be performed, including whether certain of the group's entities or business units will be considered together as a component, and the planned involvement of component auditors. This communication also helps to enable a mutual understanding of and discussion about the group and its environment (see paragraph 3024) and ~~any~~ any areas, if any, in which those charged with governance may request the group auditor to undertake additional procedures.

*Communication of Identified Deficiencies in Internal Control* (Ref: Para. 5856A)

A162A123A. ~~In accordance with ISA 265, t~~The group auditor is responsible for determining, on the basis of the audit work performed, whether one or more identified deficiencies, individually or in combination, constitute significant deficiencies.<sup>111</sup> The group auditor may request input from the component auditor ~~as to~~ about whether an identified deficiency or combination of deficiencies at the component is a significant deficiency in internal control.

**Documentation** (Ref: Para. 5957)

A163A123B. Other ISAs contain specific documentation requirements that are intended to clarify the application of ISA 230 in the particular circumstances of those other ISAs. The Appendix to ISA 230 lists other ISAs that contain specific documentation requirements and guidance.

A164A123C. The audit documentation for the group audit supports the group auditor's evaluation in accordance with paragraph 5149 as to whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion. Also see paragraph A151A145B.

A165A124. The audit documentation for the group audit comprises:

- The documentation in the group auditor's file; and
- The separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit (i.e., component auditor audit documentation).

<sup>110</sup> ISA 260 (Revised), paragraph 15

<sup>111</sup> ISA 265, paragraph 8

~~A166A124x~~. The final assembly and retention of the audit documentation for a group audit is subject to the policies or procedures of the group auditor's firm in accordance with ISQM 1.<sup>112</sup> The group auditor may provide specific instructions to component auditors regarding the assembly and retention of the documentation of work performed by them for purposes of the group audit.

*Basis for the Group Auditor's Determination of Components* (Ref: Para: ~~5957~~(b))

~~A167A124y~~. ~~Documentation of t~~The basis for the group auditor's determination of components may be ~~evidenced~~ documented in various ways, including, for example, through fulfilling documentation related to the fulfillment of the following requirements in paragraphs 22, 33 and 57(a) of this ISA:

~~Paragraph 17A, which requires the group auditor to determine the components at which audit work will be performed, based on the group auditor's understanding of the group's organizational structure and information system.~~

~~Paragraph 26B, which requires the group auditor to take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements.~~

~~Paragraph 56(a), which requires the group auditor to communicate with those charged with governance of the group an overview of the work to be performed at the components of the group and the nature of the group auditor's planned involvement in the work to be performed by component auditors.~~

*Basis for the Group Auditor's Determination of the Competence and Capabilities of Component Auditors* (Ref: Para: ~~59(d)57(ea)~~)

~~A168A124z~~. ISQM 1<sup>113</sup> provides guidance on matters that the firm's policies or procedures may address regarding the competence and capabilities of the engagement team members.<sup>114</sup> Such policies or procedures may describe or provide guidance about how to document the determination of the competence and capabilities of the engagement team, including component auditors. For example, the confirmation obtained from the component auditor in accordance with paragraph ~~2449~~ may include information about the component auditor's relevant industry experience. The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures (see paragraph ~~A59A40B~~).

*Documentation of the Direction and Supervision of Component Auditors and the Review of Their Work* (Ref: Para. ~~59(f)57(d)~~)

~~A169A124D~~. As described in paragraph ~~A72A48A~~, the approach to direction, supervision and review in a group audit will be tailored by the group auditor based on the facts and circumstances of the engagement, and will generally include a combination of addressing the group auditor's firm policies or procedures and responses specific to the group audit. Such policies or procedures may also describe or provide guidance about the documentation of the group auditor's direction and supervision of the engagement team and the review of their work.

~~A170A125~~. ISA 300<sup>115</sup> requires the auditor to ~~describe, develop an in~~ the audit plan, that includes a description of the nature, timing and extent of the planned direction and supervision of engagement team members and the review of their work. When component auditors are involved,

<sup>112</sup> ISQM 1, paragraphs 31(f) and A83–A85

<sup>113</sup> ~~ISQM 1, paragraph A96~~

<sup>114</sup> ~~ISQM 1, paragraph A96~~

<sup>115</sup> ~~ISA 300, paragraph 9~~

the extent of such descriptions will often vary by component, recognizing that the planned nature, timing and extent of direction and supervision of component auditors, and review of their work, ~~is~~ may be influenced by the ~~factors-matters~~ described in paragraph ~~A48A33F~~.

~~A171A126. When component auditors are involved in the group audit, t~~The group auditor's documentation of ~~its the direction and supervision involvement in the work~~ of component auditors and the review of their work may include, for example:

- Required communications with component auditors, including instructions issued and other confirmations required by this ISA.
- The rationale for the selection of visits to component auditor sites, attendees at meetings and the nature of the matters discussed.
- Matters discussed in ~~audioconferences or videoconferences~~meetings with component auditors or component management.
- The rationale for the group auditor's determination of component auditor audit documentation selected for review.
- Changes in the planned nature and extent of involvement with component auditors, and the reasons why.

~~A172A127. Paragraph 4745A~~ requires the group auditor to determine whether, and the extent to which it is necessary to review ~~parts of the~~additional component auditor's audit documentation. Paragraphs ~~A145A112B – A146A113~~ provide guidance for the group auditor in making this determination.

~~A173A127A. Component auditor documentation ordinarily need not be replicated in the group auditor's audit file. However, d~~Depending on the facts and circumstances, the group auditor may decide to ~~replicate~~, summarize, replicate or retain copies of certain component auditor documentation in the group auditor's audit file to supplement the description of a particular matter in communications from the component auditor, including the matters required to be communicated by this ISA. Examples of such component auditor documentation may include:

- A listing or summary of the significant judgments made by the component auditor, and the conclusions reached thereon, that are relevant to the group audit;
- Matters that may need to be communicated to those charged with governance of the group; or
- Matters that may be determined to be key audit matters to be communicated in the auditor's report on the group financial statements.

~~A174A127B. When required by law or regulation, certain component auditor documentation may need to be included in the group auditor's audit file, for example, to respond to the request of a regulatory authority to review documentation related to work performed by a component auditor.~~

~~A175A128. Policies or procedures established by the firm in accordance with the firm's system of quality management, or resources provided by the firm or a network, may assist the group auditor in documenting the direction and supervision of component auditors and the review of their work. For example, an electronic audit tool may be used to facilitate communications between the group auditor and component auditors. The electronic audit tool also may be used for audit documentation, including providing~~ evidence of information about the reviewer(s) and the date(s) and extent of their review.

*Additional Considerations When Access to Component Auditor Audit Documentation is Restricted*  
(Ref: Para. 5957)

A176A129. Audit documentation for a group audit may present some additional complexities or challenges in certain circumstances. This may be the case, for example, when law or regulation ~~may~~ restrict the component auditor from providing documentation outside of its jurisdiction, or when war, civil unrest or outbreaks of disease restrict access to relevant component auditor audit documentation.

A177A130. The group auditor may be able to overcome such restrictions ~~and access the relevant component auditor documentation by~~, for example one or more of the following:

- ~~—~~ Visiting the location of the component auditor; ~~or~~
- ~~Meeting—meeting~~ with the component auditor in a location different from where the component auditor is located, to review the component auditor's audit documentation;
- Reviewing the relevant audit documentation remotely through the use of technology, when not prohibited by law or regulation;
- Requesting the component auditor to prepare and provide a memorandum that addresses the relevant information and holding discussions with the component auditor, if necessary, to discuss the contents of the memorandum; or
- ~~—~~ Discussing with the component auditor the procedures performed, the ~~results—evidence~~ obtained and the conclusions reached by the component auditor.

It is a matter of professional judgment whether one or more of the actions described above may be sufficient to overcome the restrictions depending on the facts and circumstances of the group audit.

A178A130x. ~~In these circumstances~~When access to component auditor audit documentation is restricted, the group auditor's documentation nonetheless needs to comply with the requirements of ~~this—the~~ ISAs, including those relating to the documentation of the nature, timing and extent of the group auditor's direction and supervision of component auditors and the review of their work. The guidance in paragraphs ~~A145—A146—A113~~ may be helpful ~~to the group auditor~~ in determining the extent of the group auditor's review of the component auditor audit documentation in these circumstances. Paragraphs ~~A173A127A—~~ and ~~A174A127B~~ provide examples of circumstances in which certain component auditor audit documentation may be included in the group auditor's audit file.

A179A130A. If the group auditor is unable to ~~obtain—overcome restrictions on~~ access to the component auditor audit documentation, the group auditor may need to consider whether a scope limitation exists that may require a modification to the opinion on the group financial statements. See paragraph A42A32.

## Appendix 12

(Ref: Para. ~~A42A32~~)

### Illustration of Independent Auditor's Report Where the Group Auditor Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of consolidated financial statements of an entity other than a listed entity using a fair presentation framework. The audit is a group audit of an entity with subsidiaries (i.e., ISA 600 (Revised) applies).
- The consolidated financial statements are prepared by management of the entity in accordance with IFRSs (a general purpose framework).
- The terms of the audit engagement reflect the description of management's responsibility for the consolidated financial statements in ISA 210.
- The group auditor is unable to obtain sufficient appropriate audit evidence relating to a component accounted for by the equity method (recognized at \$15 million in the statement of financial position, which reflects total assets of \$60 million) because the group auditor did not have access to the accounting records, management, or auditor of the component.
- The group auditor has read the audited financial statements of the component as at December 31, 20X1, including the auditor's report thereon, and considered related financial information kept by group management in relation to the component.
- In the group engagement partner's judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive.<sup>1</sup>
- The IESBA Code comprises all of the relevant ethical requirements that apply to the audit.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA 570 (Revised).
- The auditor is not required, and has otherwise not decided, to communicate key audit matters in accordance with ISA 701.<sup>2</sup>
- The auditor has obtained all of the other information prior to the date of the auditor's report and the qualified opinion on the consolidated financial statements also affects the other information.
- Those responsible for oversight of the consolidated financial statements differ from those responsible for the preparation of the consolidated financial statements.
- In addition to the audit of the consolidated financial statements, the auditor has other reporting responsibilities required under local law.

<sup>1</sup> If, in the group engagement partner's judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with ISA 705 (Revised).

<sup>2</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

## INDEPENDENT AUDITOR’S REPORT

To the Shareholders of ABC Company [or Other Appropriate Addressee]

### Report on the Audit of the Consolidated Financial Statements<sup>3</sup>

#### Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at December 31, 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects (or give a true and fair view of), the consolidated financial position of the Group as at December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

#### Basis for Qualified Opinion

ABC Company’s investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at \$15 million on the consolidated statement of financial position as at December 31, 20X1, and ABC’s share of XYZ’s net income of \$1 million is included in the consolidated statement of comprehensive income for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC’s investment in XYZ as at December 31, 20X1 and ABC’s share of XYZ’s net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants’ *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

#### Other Information [or another title if appropriate such as “Information Other than the Financial Statements and Auditor’s Report Thereon”]

[Reporting in accordance with the reporting requirements in ISA 720 (Revised)<sup>4</sup> – see Illustration 6 in Appendix 2 of ISA 720 (Revised). The last paragraph of the other information section in Illustration 6 would be customized to describe the specific matter giving rise to the qualified opinion that also affects the other information.]

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<sup>3</sup> The sub-title, “Report on the Audit of the Consolidated Financial Statements” is unnecessary in circumstances when the second sub-title, “Report on Other Legal and Regulatory Requirements” is not applicable.

<sup>4</sup> ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information*

## **Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements<sup>5</sup>**

*[Reporting in accordance with ISA 700 (Revised)<sup>6</sup> – see Illustration 2 in ISA 700 (Revised).]*

## **Auditor’s Responsibilities for the Audit of the Consolidated Financial Statements**

*[Reporting in accordance with ISA 700 (Revised) – see Illustration 2 in ISA 700 (Revised). The last two paragraphs which are applicable for audits of listed entities only would not be included.]*

## **Report on Other Legal and Regulatory Requirements**

*[Reporting in accordance with ISA 700 (Revised) – see Illustration 2 in ISA 700 (Revised).]*

*[Signature in the name of the audit firm, the personal name of the auditor, or both, as appropriate for the particular jurisdiction]*

*[Auditor Address]*

*[Date]*

If, in the group engagement partner’s judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with ISA 705 (Revised).

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<sup>5</sup> Throughout these illustrative auditor’s reports, the terms management and those charged with governance may need to be replaced by another term that is appropriate in the context of the legal framework in the particular jurisdiction.

<sup>6</sup> ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*

## Appendix 23

(Ref: Para. ~~A85A53~~)

### Understanding the Group's System of Internal Control

1. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how ISA 315 (Revised 2019)<sup>1</sup> is to be applied in relation to an audit of group financial statements.<sup>2</sup> The examples may not be relevant to every group audit engagement and the list of examples is not necessarily complete.

#### Control Environment

2. The group auditor's understanding of the control environment may include matters such as the following:
  - The structure of the governance and management functions across the group, and group management's oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group.
  - How oversight over the group's system of internal control by those charged with governance is structured and organized.
  - How ethical and behavioral standards are communicated and reinforced in practice across the group, (e.g., group-wide programs, such as codes of conduct and fraud prevention programs).
  - The consistency of policies and procedures across the group, including a group financial reporting procedures manual.

#### The Group's Risk Assessment Process

3. The group auditor's understanding of the group's risk assessment process may include matters such as group management's risk assessment process, that is, the process for identifying, analyzing and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group's risk assessment process is and the involvement of entities and business units in this process.

#### The Group's Process to Monitor the System of Internal Control

4. The group auditor's understanding of the group's process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, where relevant, activities of the internal audit function across the group. The group's internal audit function, including its nature, responsibilities and activities in respect of monitoring of controls at entities or business units in the group. ISA 610 (Revised 2013)<sup>3</sup> ~~requires~~ deals with the group auditor to evaluate the extent to which 's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately supports the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a systematic and disciplined approach, including

<sup>1</sup> ISA 315 (Revised 2019), Appendix 3

<sup>2</sup> ISA 315 (Revised 2019), Appendix 3

<sup>3</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*, paragraph 15

~~quality control when the group audit team expects to use the function's work.~~

### The Information System and Communication

5. The group auditor's understanding of the group's information system and communication may include matters such as the following:

- The extent of centralization in the group's IT environment and the commonality of IT applications, IT processes and IT infrastructure.
- Group management's monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to monitor performance against budgets, and to take appropriate action.
- Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at group level.
- A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group.

### Consolidation Process

6. The group auditor's understanding of the consolidation process may include matters such as the following:

- Matters relating to the applicable financial reporting framework:
- The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework.
- The process for identifying and accounting for entities or business units in the group in accordance with the applicable financial reporting framework.
- The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework.
- The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework.
- The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework.
- The procedures for dealing with entities or business units in the group with financial year-ends different from the group's year-end.

Matters relating to the consolidation process:

- Group management's process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, ~~when~~ applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial statements, and that differences in accounting policies are identified, and adjusted ~~when~~ required in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the entities or business units in the group use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.

- Group management's process for ensuring complete, accurate and timely financial reporting by the entities or business units in the group for the consolidation.
- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial statements.
- How the group's IT environment is organized for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters relating to consolidation adjustments and reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorization and processing of related journal entries, and the experience of personnel responsible for the consolidation.
- The consolidation adjustments required by the applicable financial reporting framework.
- The business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature and size of transactions between entities or business units in the group.
- The procedures for monitoring, controlling, reconciling and eliminating intra-group transactions and unrealized profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (where applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework.
- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (e.g., an obligation of the minority interest to make good such losses).

### Control Activities

7. The group auditor's understanding of the control activities component may include matters such as the following:

- ~~• The extent of centralization in the group's IT environment and the commonality of IT applications, IT processes and IT infrastructure.~~
- The commonality of information processing controls and general IT controls for all or part of the group.
- The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial statements at the assertion level.
- The extent to which commonly designed controls have been implemented consistently for all or part of the group.

**Appendix 34**(Ref: Para. [A110A84](#))**Examples of Events or Conditions that May Give Rise to Risks of Material Misstatement of the Group Financial Statements**

The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement ~~of~~ in the group financial statements, ~~whether due to fraud or error at the financial statement level or the assertion level~~, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degree. Also see ISA 315 (Revised 2019), Appendix 2.

Inherent Risk Factor	Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Statements at the Assertion Level:
Complexity	<ul style="list-style-type: none"> <li>• The existence of complex transactions that are accounted for in more than one entity or business units in the group.</li> <li>• The application of accounting policies by entities or business units in the group that differ from those applied to the group financial statements.</li> <li>• Accounting measurements or disclosures that involve complex processes used by entities or business units in the group such as accounting for complex financial instruments.</li> <li>• Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation.</li> </ul>
Subjectivity	<ul style="list-style-type: none"> <li>• Judgments regarding which entities or business units in the group require incorporation of their financial information in the group financial statements in accordance with the applicable financial reporting framework, for example, whether any special-purpose entities or non-trading entities exist and require incorporation.</li> <li>• Judgments regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group.</li> </ul>
Change	<ul style="list-style-type: none"> <li>• Frequent acquisitions, disposals or reorganizations.</li> </ul>
Uncertainty	<ul style="list-style-type: none"> <li>• Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade and fiscal policy, and restrictions</li> </ul>

	on currency and dividend movements; and fluctuations in exchange rates.
Susceptibility to Misstatement Due to Management Bias or Other Fraud Risk Factors Insofar as They Affect Inherent Risk	<ul style="list-style-type: none"> <li>• Unusual related party relationships and transactions.</li> <li>• Entities or business units in the group with different financial year-ends, which may be utilized to manipulate the timing of transactions.</li> <li>• Prior occurrences of unauthorized or incomplete consolidation adjustments.</li> <li>• Aggressive tax planning within the group, or large cash transactions with entities in tax havens.</li> <li>• Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.</li> <li>• Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk</li> </ul>

Indicators that the control environment, the group's risk assessment process or the group's process to monitor the group's system of internal control are not appropriate to the group's circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group's system of internal control, include:

- Poor corporate governance structures, including decision making processes that are not transparent.
- Non-existent or ineffective controls over the group's financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group.

**Appendix — Amendments to Various Statements on Auditing Standards to Reflect the Proposed SAS *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***

(***Boldface italics*** denotes new language. Deleted text is shown in ~~strikethrough~~)

**Amendment to SAS No. 117, *Compliance Audits*, as Amended (AICPA, *Professional Standards*, AU-C Section 935)**

1. The amendment to AU-C section 935 is effective for compliance audits for fiscal periods beginning on or after December 15, 2025.

**Introduction and Applicability**

[No amendment to paragraphs .01–.A42.]

**Appendix — AU-C Sections That Are Not Applicable to Compliance Audits <sup>[fn 1]</sup>**

**.A43** The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor’s opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
...	
<b>600, <i>Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)</i></b>	<b>Paragraphs <del>2650.5.1, 3940, 41e31b, 50.9b, 41d50.9c, and 31a, 55, and 56e</del></b>
...	

<sup>[fn 1]</sup> [Footnote omitted for purposes of this proposed SAS.]

[No further amendment to AU-C section 935.]

**Amendments to Various Sections in SAS No. 122, as Amended (AICPA, *Professional Standards*, AU-C secs. 230, 260, 300, 320, 402, 450, 501, 510, 550, 805, 920, and 930)**

**AU-C Section 230, *Audit Documentation***

2. The amendment to AU-C section 230 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A29.]

**Exhibit — Audit Documentation Requirements in Other AU-C Sections**

**.A30** The following lists the main paragraphs in other AU-C sections that contain specific documentation requirements. This list is not a substitute for knowledge of the AU-C sections:

...

- q. Paragraphs ~~.59.49 and .64~~ of section ~~600~~, ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***

...

[No further amendment to AU-C section 230.]

**AU-C Section 260, *The Auditor’s Communication With Those Charged With Governance***

3. The amendment to AU-C section 260 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A8.]

## Those Charged With Governance

...

~~.A9 Section 600,~~ ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***, includes specific matters to be communicated by *the* group auditor~~s~~ with those charged with governance *of the group*.<sup>fn 3</sup> ***The matters communicated may include those brought to the attention of the group auditor by component auditors that the group auditor judges to be significant to the responsibilities of those charged with governance of the group. Component auditors also may communicate matters to those charged with governance of the component.***<sup>fn 4</sup> When the entity being audited is a component of a group, the appropriate person(s) with whom to communicate is dependent on the nature of the matter to be communicated and the terms of the engagement.

fn 3 Paragraphs ~~.57 .45–.48~~ of ~~section 600,~~ ***Proposed Statement on Auditing Standards (SAS) Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***

***fn 4 Paragraph .45i of Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***

[No amendment to paragraphs A10–A57.]

## Exhibit — Requirements to Communicate With Those Charged With Governance in Other AU-C Sections

~~.A58~~ Requirements for the auditor to communicate with those charged with governance are included in other AU-C sections. This section does not change the requirements in

~~...i. paragraphs .45–.48 .57 of section 600,~~ ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***

...

[No further amendment to AU-C section 260.]

## AU-C Section 300, *Planning an Audit*

4. The amendment to AU-C section 300 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

### Scope of This Section

**.01** This section addresses the auditor’s responsibility to plan an audit of financial statements. This section is written in the context of recurring audits. Additional considerations in an initial audit engagement are separately identified in this section. Matters related to planning audits of group financial statements are addressed in ~~section 600,~~ ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***. (Ref: par. .A1–.A3)

[No amendment to paragraphs .02–.10]

### Requirements

...

#### Planning Activities

...

***10A. The engagement partner should review the overall audit strategy and audit plan.***

[No amendment to paragraphs .11–.A9]

### Application and Other Explanatory Material

...

#### Planning Activities

*The Overall Audit Strategy (Ref: par. .07-.08)*

**.A9** The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor’s risk assessment procedures, such matters as the following:

- The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of specialists on complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the ***nature and extent of direction and supervision of component auditors and the review of their component auditors’*** work in the case of group audits, or the audit budget (in hours) to allocate to high risk areas
- When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- How such resources are managed, directed, and supervised, such as when team briefing and debriefing meetings are expected to be held, how the engagement partner and manager reviews are expected to take place (for example, on site or off site), and whether to complete engagement quality control reviews
- ***The components for which, if any, the auditor’s report on the group financial statements will make reference to the audit of a referred-to auditor***

[No amendment to paragraphs .A10–.A26]

**Appendix — Considerations in Establishing the Overall Audit Strategy (Ref: par. .07–.08 and .A9–.A12)**

.A27 This appendix provides examples of matters the auditor may consider in establishing the overall audit strategy. Many of these matters also will influence the auditor’s detailed audit plan. The examples provided cover a broad range of matters applicable to many engagements. Although some of the following matters may be required by other AU-C sections, not all matters are relevant to every audit engagement, and the list is not necessarily complete.

...

**Characteristics of the Engagement**

...

- The expected audit ~~coverage~~ *scope*, including the ~~number and locations of components~~ *at which audit work is expected to be performed for purposes of a group audit, the extent to which component auditors will be involved, and the components that are audited by referred-to auditors for which the group auditor plans to make reference to in the auditor’s report on the group financial statements* ~~to be included~~
- The nature of the control relationships between a parent and its *entities or business units* ~~components~~ that determine how the group is to be consolidated
- ~~• The extent to which components are audited by other auditors~~
- The nature of the business divisions to be audited, including the need for specialized knowledge
- The reporting currency to be used, including any need for currency translation for the audited financial information
- The *requirement* ~~need~~ for *an audit of financial statements for legal, statutory or regulatory, or other reasons* ~~audit requirements~~ (for example, the Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*)

...

### **Reporting Objectives, Timing of the Audit, and Nature of Communications**

...

- Communication with **component** auditors of ~~components~~ regarding the expected types and timing of ~~reports to be issued and other~~ communications in connection with the audit **work performed for purposes of the group audit** of ~~components~~
- **Communication with referred-to auditors regarding the expected types and timing of communications in connection with making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements**
- The expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of **audit** work performed

...

### **Significant Factors, Preliminary Engagement Activities, and Knowledge Gained on Other Engagements**

The following examples illustrate significant factors, preliminary engagement activities, and knowledge gained on other engagements:

- The determination of materiality, in accordance with section 320, *Materiality in Planning and Performing an Audit*, and, when applicable, the following:
  - The determination of **component performance** materiality for ~~components~~ and **the threshold above which misstatements identified in the component financial information are to be communicated to the group auditor and** communication thereof to component auditors in accordance with ~~section 600~~, **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 **initial expectations about the** preliminary identification of significant ~~components and material~~ classes of transactions, account balances, and disclosures **that may be significant**

...

[No further amendment to AU-C section 300.]

## **AU-C Section 320, Materiality in Planning and Performing an Audit**

5. The amendment to AU-C section 320 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.08.]

### **Definition**

.09 For purposes of generally accepted auditing standards (GAAS), the following term has the meaning attributed as follows:

**Performance materiality.** The amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce *aggregation risk* to an appropriately low level ~~the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.~~ If applicable, *performance materiality* also refers to the amount or amounts set by the auditor at less than the materiality level or levels for particular classes of transactions, account balances, or disclosures. Performance materiality is to be distinguished from tolerable misstatement. (Ref: par. .A3)

*Aggregation Risk. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole.*

...

### **Application and Other Explanatory Material**

...

### **Determining Materiality and Performance Materiality When Planning the Audit**

...

#### ***Performance Materiality (Ref: par. .11)***

**.A15** Planning the audit solely to detect individual material misstatements overlooks the fact that the aggregate of individually immaterial misstatements may cause the financial statements to be materially misstated and leaves no margin for possible undetected misstatements. *Performance materiality* (which, as defined, is one or more amounts) is set ***at less than materiality for the financial statements as a whole*** to reduce *aggregation risk* to an appropriately low level ~~the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole.~~ Similarly, performance materiality relating to a materiality level determined for a

particular class of transactions, account balance, or disclosure is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in that particular class of transactions, account balance, or disclosure exceeds the materiality level for that particular class of transactions, account balance, or disclosure. The determination of performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. It is affected by the auditor's understanding of the entity, updated during the performance of the risk assessment procedures, and the nature and extent of misstatements identified in previous audits and, thereby, the auditor's expectations regarding misstatements in the current period.

[No further amendment to AU-C section 320.]

**AU-C Section 402, *Audit Considerations Relating to an Entity Using a Service Organization***

6. The amendment to AU-C section 402 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A18.]

**Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control**

...

***Further Procedures When a Sufficient Understanding Cannot Be Obtained From the User Entity***

...

**.A19** Another auditor may be used to perform procedures that will provide the necessary information about the controls at the service organization related to services provided to the user entity. If a type 1 or type 2 report has been issued, the user auditor may use the service auditor to perform these procedures as the service auditor has an existing relationship with the service organization. The user auditor using the work of another auditor may find the guidance in ~~section~~ ***Proposed Statement on Auditing Standards Quality Management for Engagements Conducted in Accordance with GAAS 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)***, useful as it relates to ***determining the competence and capabilities of the other*** ~~understanding another auditor (including that auditor's independence and professional competence); ***the direction and supervision*** involvement in the work of ***the other*** another auditor, in planning the nature, extent, and timing of such ~~the~~ ***work assigned to the other auditor***; and in evaluating the sufficiency and appropriateness of the audit evidence obtained.~~

<sup>fn 9</sup> ***Proposed Statement on Auditing Standards Quality Management for Engagements Conducted in Accordance with GAAS Paragraphs .02 and .22 of section 600, Special Considerations—Audits of Group***

*Financial Statements (Including the Work of Component Auditors).*

[No further amendment to AU-C section 402.]

**AU-C Section 450, *Evaluation of Misstatements Identified During the Audit***

7. The amendment to AU-C section 450 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A24.]

**Evaluating the Effect of Uncorrected Misstatements**

...

**.A25** The auditor is required by ~~section 600,~~ ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***, to evaluate the effect on the group audit opinion of any uncorrected misstatement identified by the group **auditor engagement team** or communicated by the component auditors.<sup>fn 18</sup>

<sup>fn 18</sup> Paragraph ~~.52-44~~ of ~~section 600,~~ ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No further amendment to AU-C section 450.]

**AU-C Section 501, *Audit Evidence — Specific Considerations for Selected Items***

8. The amendment to AU-C section 501 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–A4.]

**Investments in Securities and Derivative Instruments**

...

***Investments in Securities When Valuations Are Based on the Investee’s Financial Results (Excluding Investments Accounted for Using the Equity Method of Accounting) (Ref: par. .05–.06)***

~~.A5~~ ~~Section 600,~~ ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***, addresses auditing investments accounted for using the

equity method of accounting.

[No amendment to paragraphs A6–A22.]

## **Inventory**

### ***Attendance at Physical Inventory Counting***

...

.A23 Matters relevant in planning attendance at physical inventory counting (or in designing and performing audit procedures pursuant to paragraphs .12–.16) include, for example, the following:

...

- The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate. ~~Section 600 addresses the involvement of component auditors and, accordingly, may be relevant if such involvement is with regard to attendance of physical inventory counting at a remote location.~~

...

[No further amendment to AU-C section 501.]

### ***AU-C Section 510, Opening Balances — Initial Audit Engagements, Including Reaudit Engagements***

9. This amendment to AU-C section 510 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A7.]

## **Audit Procedures**

...

.A8 If the predecessor auditor permits access to the audit documentation, the auditor may review the predecessor auditor’s audit documentation for information relevant to planning and performing the audit. The auditor’s determination whether to use information resulting from such review as part of the auditor’s risk assessment procedures or as evidence regarding the opening balances is influenced by the auditor’s assessment of the professional competence and independence of the predecessor auditor. Although the predecessor auditor

is not a component auditor *or referred-to auditor*, as defined in ~~section 600~~, ***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 auditor may ***perform procedures*** ~~make inquiries~~ similar to those ***included*** ~~listed~~ in section 600 concerning the ~~professional competence~~ ***and capabilities*** and independence of the predecessor auditor. <sup>fn1</sup> (Ref: par. .07 and .08c)

<sup>fn1</sup>. Paragraphs ~~22.25, 26, 50.1, and 50.2~~ of ~~section 600~~, ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No further amendment to AU-C section 510.]

### **AU-C Section 550, *Related Parties***

10. The amendment to AU-C section 550 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A10.]

### **Risk Assessment Procedures and Related Activities**

#### ***Understanding the Entity’s Related Party Relationships and Transactions***

##### ***The Identity of the Entity’s Related Parties***

...

**.A11** In the context of a group audit, ~~section 600~~, ***Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***, requires the group auditor engagement team to ***request component auditors and referred-to auditors to communicate on a timely basis related party relationships not previously identified by group management or the group auditor*** ~~provide each component auditor with information about related parties prepared by group management and any other related parties of which the group engagement team is aware, including the nature of the entity's relationships and transactions with those related parties.~~ <sup>fn 24</sup> When the entity is a component within a group, ***this*** ***Such*** information provides a useful basis for the ***group*** auditor’s inquiries of management regarding the identity of ~~the entity’s~~ related parties.

<sup>fn 24</sup> Paragraph ~~.32b.40e and 50.9d(ii)~~ of ~~section 600~~ ***Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No amendment to paragraphs A12–A30.]

***Sharing Related Party Information With the Engagement Team***

...

**.A31** ~~Section 600~~, ***Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** addresses the communications that apply to group audits, particularly those that involve component auditors ***or when reference is made to referred-to auditors.***

[No amendment to paragraphs A32–A41.]

**Responses to the Risks of Material Misstatement Associated With Related Party Relationships and Transactions (Ref: par. .22)**

...

***Identified Related Party Transactions Required To Be Disclosed or Determined to be a Significant Risk***

*Evaluating the Business Purpose (Ref: par. .26a(i))*

**.A42** In evaluating the business purpose of a related party transaction that is required to be disclosed in the financial statements or determined to be a significant risk, the auditor may consider the following:

- Whether the transaction
  - is overly complex (for example, it may involve multiple related parties within a ~~consolidated~~ group)

...

[No further amendment to AU-C section 550]

**AU-C Section 805, *Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement***

**11.** The amendment to AU-C section 805 is effective for audits of single financial statements or specific elements, accounts, or items of a financial statement as of or for periods beginning on or after December 15, 2025.

**Scope of This Section**

[No amendment to paragraph .01.]

**.02** This section does not apply to ***circumstances in which*** ~~the report~~ ***audit procedures are***

~~*performed by*~~ of a component auditor issued as a result of work performed on the financial information of a component at the request of a group engagement team for purposes of an audit of group financial statements (see section 600, ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors and Audits of Referred-to Auditors]***).

[No further amendment to AU-C section 805]

#### **AU-C Section 920, Letters for Underwriters and Certain Other Requesting Parties**

12. The amendment to AU-C section 920 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.19.]

#### **Requirements**

...

#### **Agreeing Upon the Scope of Services**

...

.21 Situations may exist in which one or more component auditor's *or referred-to auditor's* report is included in the securities offering. When comfort letters are issued to requesting parties by those component auditors *or referred-to auditors*, the auditor of the group financial statements should read those comfort letters. The auditor of the group financial statements should state in the comfort letter that the procedures relating to those components consisted solely of reading the component auditors' *or referred-to auditors'* comfort letters.

[No amendment to paragraphs .22–.A18.]

#### **Application and Other Explanatory Material**

...

#### **Agreeing Upon the Scope of Services (Ref: par. .15–.23)**

...

**.A19** Comfort letters are requested occasionally from more than one auditor, for example, in connection with securities offerings to be used in the subsequent sale of shares issued in recently effected mergers and from predecessor auditors. In such circumstances, it is the entity's responsibility, at the earliest practicable date, to inform any other auditors who may be involved about any letter that may be requested of them and arrange for them to receive a draft of the underwriting agreement so that they may make arrangements at an early date for the preparation of a draft of their letter and for the performance of their procedures. The

entity or requesting party is also responsible for arranging for a copy of the comfort letters of component auditors *or referred-to auditors* in draft and final form to be provided to the auditor of the group financial statements.

...

#### **Format and Contents of Comfort Letters**

...

##### ***Addressee (Ref: par. .26)***

.A27 An example of an appropriate form of address for this purpose is "The Blank Company and XYZ & Company, as Representative of the Several Underwriters." Copies of a comfort letter addressed in accordance with the requirements in paragraph .26 may be provided to the auditor of the group financial statements when a comfort letter related to a component included in group financial statements is issued by a component auditor *or referred-to auditor*.

...

#### **Commenting in a Comfort Letter on Information Other Than Audited Financial Statements**

...

##### ***Subsequent Changes (Ref: par. .58–.64)***

...

.A70 When more than one auditor is involved, the auditor of the group financial statements may comment that there were no decreases in the consolidated financial statement items, when appropriate, despite the possibility that decreases have been mentioned in a comfort letter issued by a component auditor *or referred-to auditor*. Exhibit B, example J, "Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor*," contains an illustration of wording when more than one auditor is involved.

#### **Exhibit B — Examples of Comfort Letters —**

##### **.A93**

...

Example J — Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor*

...

**Example J — Alternate Wording When Component Auditors Are Involved *or When Making Reference to the Audit of a Referred-to Auditor***

**.A93-14** Example J applies when one or more component auditors are involved in the audit of group financial statements *or when reference is made to the audit of a referred-to auditor in the auditor’s report on group financial statements*, and the group engagement team has obtained a copy of the comfort letter of the component auditors *or referred-to auditors* (see paragraph .21). Example J consists of an addition to paragraph 4, a substitution for the applicable part of paragraph 5, and an addition to paragraph 6 of example A-1 and corresponding changes to paragraphs 3, 4, and 5 of example A-2, respectively.

[No further amendment to AU-C section 920]

**AU-C Section 930, *Interim Financial Information***

13. The amendment to AU-C section 930 is effective for reviews of interim financial information for interim periods of fiscal years beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.13.]

**Procedures for a Review of Interim Financial Information**

...

***Analytical Procedures, Inquiries, and Other Review Procedures***

...

***Inquiries and Other Review Procedures***

.14 The auditor should make the following inquiries and perform the following other review procedures when conducting a review of interim financial information:

*a.* Read the available minutes of meetings of stockholders, directors, and appropriate committees and inquire about matters dealt with at meetings for which minutes are not available to identify matters that may affect the interim financial information. (Ref: par. .A16)

*b.* Obtain reports from component auditors, if any, related to reviews performed of the interim financial information of ~~significant~~ components of the reporting entity ***for which further audit procedures on the financial information of the component are performed for purposes of the audit***, including its investees, or inquire of those auditors if reports have not been issued. (Ref: par. .A17)

...

[No amendment to paragraphs .15–.A16.]

## Application and Other Explanatory Material

### Procedures for a Review of Interim Financial Information

...

#### *Analytical Procedures, Inquiries, and Other Review Procedures*

...

#### *Inquiries and Other Review Procedures*

...

**.A17** The auditor may find the guidance in ~~section 600~~, ***Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***, useful in conducting a review of interim financial information for an entity that prepares group financial statements.

[No amendment to paragraphs A18-A54.]

### Relevant Ethical Requirements

...

**.A55** Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA code, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be complex. ~~Section 600~~, ***Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***<sup>fn 11</sup> provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor *or referred-to auditor* does not meet the independence requirements that are relevant to the group audit.

<sup>fn 11</sup> Paragraphs ~~22–23~~ **25, 27, 45c, 50.1, 50.3 and 50.10a** of ~~section 600~~, ***Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No amendment to paragraphs A56-A78.]

### Exhibit B — Illustrations of Auditor’s Review Reports on Interim Financial Information (Ref: par. .A44)

**.A79**

...

Illustration 3 — A Review Report That Refers to a ~~Referred-to Component~~ Auditor’s Review Report on the Interim Financial Information of a ~~Significant~~ Component of a Reporting Entity

...

Illustration 3 — A Review Report That Refers to a ~~Referred-to Component~~ Auditor’s Review Report on the Interim Financial Information of a ~~Significant~~ Component of a Reporting Entity

Circumstances include the following:

- A review of interim financial information presented as a complete set of financial statements, including disclosures.
- The auditor is making reference to ~~a referred-to another~~ auditor’s review report on the interim financial information of a ~~significant~~ component of a reporting entity.

...

[No further amendment to AU-C section 930]

**Amendment to SAS No. 128, *Using the Work of Internal Auditors* (AICPA, *Professional Standards*, AU-C sec. 610)**

14. The amendment to AU-C section 610 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

**AU-C Section 610, *Using the Work of Internal Auditors* (AICPA, *Professional Standards*, AU-C sec. 610)**

[No amendment to paragraphs .01–.A19.]

**Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used in Obtaining Audit Evidence**

...

***Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence***

*Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function That Can Be Used*

...

**.A20** In accordance with section 330, the external auditor is required to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.<sup>fn 9</sup> Further audit procedures comprise tests of controls and substantive procedures. Procedures planned or performed by the internal audit function may be the same as, or be similar to, the further audit procedures that the external auditor would design and perform. Accordingly, subject to the requirements of this section, the external auditor may determine that it is appropriate to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of further audit procedures to be performed directly by the external auditor. The internal audit function may have performed, or may be planning to perform

- tests of relevant controls upon which the external auditor intends to rely in determining the nature, timing, and extent of substantive procedures. For example, the work of the internal audit function may include tests of relevant controls that address the risks of material misstatement related to the completeness of accounts payable. The results of the internal audit function's tests may provide evidence about the effectiveness of controls and, accordingly, the external auditor may be able to use such tests of controls performed by the internal audit function to modify the nature or timing, or reduce the extent of, testing of controls the external auditor would otherwise have performed directly.
- substantive procedures. For example, the internal audit function, as part of its work, may confirm certain accounts receivable and observe certain physical inventories. By using such work of the internal audit function in obtaining audit evidence, the external auditor may be able to change the timing of the confirmation procedures, the number of accounts receivable to be confirmed, or the number of locations of physical inventories to be observed.

The internal audit function's plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) ***in determining the components at which audit work will be performed*** and ~~reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures~~ in accordance with the requirements of ***Proposed Statement on Auditing Standards*** section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

<sup>fn 9</sup> [Footnote omitted for purposes of this proposed SAS.].

[No further amendment to AU-C section 610]

**Amendment to SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*, as Amended (AICPA, Professional Standards, AU-C sec. 940)**

15. The amendment to AU-C section 940 is effective for integrated audits for periods beginning on or after December 15, 2025.

**AU-C section 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements***

[No amendment to paragraphs .01–.77.]

**Report Modifications**

- .67** The auditor should modify the report on ICFR if any of the following conditions exist:
- a. One or more material weaknesses exist.
  - b. Elements of management’s report are incomplete or improperly presented.
  - c. There is a limitation on the scope of the engagement. (Ref: par. .A118)
  - d. The auditor decides to refer to the report of a *referred-to component* auditor as the basis, in part, for the auditor’s own opinion.
  - e. There is other information contained in management's report.

...

***Making Reference to a Referred-to ~~Component~~ Auditor and Involving ~~Assuming~~ Responsibility for the Work of a Component Auditors in the Group Audit***

**.78** ~~In a group audit~~ When an entity includes one or more components, the group engagement partner should *determine* ~~evaluate~~ whether the group engagement team will be able to obtain 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*, through the group engagement team’s work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or making reference to the audit of ICFR of a component auditor in the auditor’s report) ~~to provide a basis for forming an opinion on~~ *act as the auditor of the ICFR over the group financial statements and report as such on the ICFR over the group financial statements, as required by section 600, Proposed Statement on Auditing Standards (SAS), Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors).*<sup>fn 9</sup> (Ref: par. .A127)

<sup>fn 9</sup> Paragraph ~~.17-15~~ of *Proposed Statement on Auditing Standards (SAS) section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*

**.79** As required by ~~section 600~~, *Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* the group engagement partner should determine whether to make reference to *the audit of a referred-to component auditor* in the *auditor's* report on the ICFR over the group financial statements. <sup>fn 10</sup> Reference to the audit of a *referred-to component auditor* in the auditor's report on the ICFR over the group financial statements should not be made unless

- a. the engagement partner has determined that the *referred-to component auditor* has performed an audit of the component's ICFR in accordance with the relevant requirements of GAAS (or, if applicable, the standards promulgated by the PCAOB) and
- b. the *referred-to component auditor* has issued an auditor's report on ICFR that is not restricted as to use. (Ref: par. .A128–.A129)<sup>fn 10A</sup>

<sup>fn 10</sup> Paragraph .24 50.4 of ~~section 600~~, *Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

<sup>fn 10A</sup> *Paragraph 50.5 of Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[No amendment to paragraph 80.]

## Special Topics

### *Entities With Multiple Components*

.81 In determining the components at which to perform tests of controls, the group *auditor engagement team* should **take responsibility for the identification and assessment of** the risk of material misstatement to the *group* financial statements associated with the component and correlate the amount of attention devoted to the component with the degree of risk. (Ref: par. .A132–.A134)

.82 In assessing and responding to risk, the group *auditor engagement team* should **take responsibility for testing** ~~, or have a component auditor test on the group engagement team's behalf,~~ controls over specific risks that present a reasonable possibility of material misstatement to the group financial statements. (Ref: par. .A135)

.83 In applying the requirement in paragraph .42 regarding special considerations for subsequent years' audits, the group *auditor engagement team* should vary the nature, timing, and extent of tests of controls at components from year to year.

[No amendment to paragraphs 84-A126.]

## Report Modifications

...

***Making Reference to a Referred-to Component Auditor and Involving Assuming Responsibility for the Work of a Component Auditors in the Group Audit*** (Ref: par. .78–.79)

**A127** ~~Section 600,~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** addresses special considerations that apply to group audits, in particular those that involve component auditors *or when reference is made to referred-to auditors*. ~~Section 600~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to multiple components discussed beginning in paragraphs .28 and .81.

**A128** The group engagement partner may *determine* ~~decide to~~ *involve* ~~assume responsibility for the work of the~~ component auditors or to make reference to the *audit of a referred-to component auditor* in the report on the ICFR over the group financial statements. The decision about whether to make reference to *the audit of a referred-to component auditor* in the report on the audit of ICFR might differ from the corresponding decision as it relates to the audit of the financial statements. For example, the audit report on the group financial statements may make reference to the audit of a significant equity investment performed by a *referred-to component auditor*, but the report on the ICFR over the group financial statements might not make a similar reference because management’s assessment about ICFR ordinarily would not extend to controls at the equity method investee. See paragraph .84 for further discussion of the evaluation of the controls for an equity method investment.

**A129** ~~Section 600~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** establishes requirements and provides guidance when *involving assuming responsibility for the work of a component auditors in a group audit* and when making reference to *the audit of a referred-to component auditor* in the auditor’s report on the *group* financial statements that are adapted and applied, as necessary, to the audit of ICFR. Exhibit A of this section includes an illustration of the application of the reporting requirements in ~~section 600,~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.<sup>fn 32</sup>

<sup>fn 32</sup> Illustration 4, "Unmodified Opinion on ICFR Making Reference to *the Audit of a Referred-to Component Auditor*," of exhibit A.

[No amendment to paragraphs A130–A131.]

## Special Topics

### *Entities With Multiple Components* (Ref: par. .81–.83)

~~.A132~~ As indicated in paragraph .A127 of this section, ~~section 600~~ **Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** is applicable, adapted as necessary, to the audit of ICFR, considering the requirements and guidance related to components discussed in this section.

~~.A133~~ In determining the components at which to perform tests of controls, the group *auditor engagement team* may also take into account work performed by the internal audit function or others on behalf of management. For example, if the internal audit function’s planned procedures include relevant audit work at various components, the auditor may coordinate work with the internal auditors ***in determining the components at which test of controls will be performed*** and reduce the number of components at which the group engagement team, or a component auditor on the group engagement team’s behalf, would otherwise need to perform audit procedures.

~~.A134~~ The group engagement team may eliminate from further consideration components that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the group financial statements.

~~.A135~~ In lower risk components, the group engagement team first might evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides sufficient appropriate audit evidence. The group engagement team or a component auditor on the group engagement team’s behalf may test the operating effectiveness of controls over specific risks or group-wide controls.

[No amendment to paragraphs A136–A154.]

### **Exhibit A — Illustrative Reports**

~~.A155~~ The following illustrate the report elements described in this section. The illustrations assume that the audit of internal control over financial reporting (ICFR) and the audit of the financial statements were performed by the same auditor. Report modifications are discussed beginning in paragraph .67 of this section.

Illustration 1 — Unmodified Opinion on ICFR

Illustration 2 — Adverse Opinion on ICFR

Illustration 3 — Disclaimer of Opinion on ICFR

Illustration 4 — Unmodified Opinion on ICFR Making Reference to ***the Audit of a Referred-to a Component Auditor***

Illustration 5 — Combined Report Expressing an Unmodified Opinion on ICFR and an Unmodified Opinion on the Financial Statements

...

**Illustration 4 — Unmodified Opinion on ICFR Making Reference to *the Audit of a Referred-to-a-Component Auditor***

The following is an illustrative report expressing an unmodified opinion on ICFR when the engagement partner decides to make reference to the *audit report* of a *referred-to-component auditor*.

...

[No further amendment to AU-C section 940.]

**Amendment to SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, as Amended, Sections 700, *Forming an Opinion and Reporting on Financial Statements*, and Section 701, *Communicating Key Audit Matters in the Independent Auditor’s Report* (AICPA, *Professional Standards*, AU-C sec. 700 and 701)**

**AU-C Section 700—*Forming an Opinion and Reporting on Financial Statements***

16. The amendment to AU-C section 700 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A38.]

**Auditor’s Report**

...

***Auditor’s Report for Audits Conducted in Accordance With GAAS***

...

***Basis for Opinion***

...

**.A39** Relevant ethical requirements may exist in several different sources, such as ethical codes and additional rules and requirements within law and regulation. When independence and other relevant ethical requirements are contained in a limited number of sources, the auditor may choose to name the relevant sources (for example, the AICPA Code of Professional Conduct, when applicable; the rule or applicable regulation; or *Government Auditing Standards* promulgated by the Comptroller General of the United States) or may refer to a term that appropriately describes those sources. Relevant ethical requirements, including those pertaining to independence, in a group audit situation may be

complex. ~~Section 600, Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)~~; <sup>fn 21</sup> provides guidance for auditors in performing work on the financial information of a component for a group audit, including those situations in which the component auditor *or referred-to auditor* does not meet the independence requirements that are relevant to the group audit.

<sup>fn 21</sup> Paragraphs ~~22–23~~ **25, 27, 45c, 50.1, 50.3 and 50.10a** of ~~section 600, Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)~~.

[No amendment to paragraphs .A40–.A80.]

**Exhibit — Illustrations of Auditor’s Reports on Financial Statements (Ref: par. .A24, .A32, .A65, and .A71)**

**.A81**

...

**Illustration 4 — An Auditor’s Report on Comparative Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America When the Audit Has Been Conducted in Accordance With Both Auditing Standards Generally Accepted in the United States of America and International Standards on Auditing**

Circumstances include the following:

- Audit of a complete set of general purpose financial statements (comparative). The audit is a group audit. The auditor is not making reference to *the audit of a referred-to component* auditor in the auditor’s report.

...

[No further amendment to AU-C section 700.]

**AU-C Section 701, *Communicating Key Audit Matters in the Independent Auditor’s Report***

17. The amendment to AU-C section 701 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A12.]

## Determining Key Audit Matters

...

### *Matters That Required Significant Auditor Attention*

...

**.A13** Certain AU-C sections, such as the following, require specific communications with those charged with governance and others that may relate to areas of significant auditor attention:

- a. Section 260, *The Auditor's Communication With Those Charged With Governance*, requires the auditor to communicate significant difficulties, if any, encountered during the audit with those charged with governance.<sup>fn 7</sup> For example, there may be potential difficulties relating to the following:
  - i. Related party transactions. In particular, there may be limitations on the auditor's ability to obtain audit evidence that all other aspects of a related party transaction (other than price) are equivalent to those of a similar arm's length transaction.<sup>fn 8</sup>
  - ii. Limitations on the group audit. For example, ~~the group engagement team's~~ access to information *or people* may be restricted.<sup>fn 9</sup>

<sup>fns 7-8</sup> [Footnotes omitted for purposes of this proposed SAS.]

<sup>fn 9</sup> Paragraph ~~49d~~ 57c of *Proposed Statement on Auditing Standards* section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*.

[No further amendment to AU-C section 701]

### **AU-C Section 705, *Modification to the Opinion in the Independent Auditor's Report***

18. The amendment to AU-C section 705 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

[No amendment to paragraphs .01–.A10.]

**.A11** Examples of circumstances beyond the control of the entity include the following:

- The entity's accounting records have been destroyed.
- The accounting records of a ~~significant~~ component *for which further audit procedures are determined to be necessary for purposes of the group audit* have been seized indefinitely by governmental authorities.

[No amendment to paragraphs .A12–.A37.]

**Exhibit — Illustrations of Auditor’s Reports With Modifications to the Opinion  
.A38**

...

Illustration 3 — An Auditor’s Report Containing an Adverse Opinion Due to a Material Misstatement of the Financial Statements

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (single year). The audit is a group audit. The auditor is not making reference to *the audit of a referred-to component* auditor in the auditor’s report.

...

[No further amendment to AU-C section 705]

**Amendment to SAS No. 137, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports*, as Amended (AICPA, *Professional Standards*, AU-C sec. 720)**

19. The amendment to AU-C section 720 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

**AU-C section 720, *The Auditor’s Responsibilities Relating to Other Information Included in Annual Reports***

[No amendment to paragraphs .01–.A35.]

**Reading and Considering the Other Information (Ref: par. .16–.17)**

...

**.A36** In the case of a group audit, though the group auditor is required to read the entirety of the other information if, in accordance with ~~section 600~~, *Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*,<sup>fn 10</sup> the group auditor decides to make reference to *the audit of a referred-to component* auditor in the auditor’s report on the group financial statements, the group auditor’s knowledge does not extend beyond that obtained by the group auditor during the audit of the group financial statements.

<sup>fn10</sup> Paragraph ~~.24.50.4~~ of ~~section 600~~, *Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*

[No amendment to paragraphs .A37–.A38.]

**.A39** The manner in which an auditor resolves a concern regarding whether other

information is materially inconsistent with the auditor’s knowledge obtained in the audit, is a matter of professional judgment. The auditor may determine that referring to relevant audit documentation or making inquiries of relevant members of the engagement team, **including** ~~or~~ relevant component auditors, is appropriate as a basis for the auditor’s consideration of whether a material misstatement exists. Whether, and if so, the extent to which, the auditor refers to relevant audit documentation or makes inquiries of relevant members of the engagement team, **including** ~~or~~ relevant component auditors, is a matter of professional judgment.

**.A40** It may not be necessary for the auditor to refer to relevant audit documentation or to make inquiries of relevant members of the engagement team, **including** ~~or~~ relevant component auditors, about any matter included in the other information. This may be the case, for example, when the group auditor decides to make reference to ***the audit of a referred-to component auditor*** in the auditor’s report in accordance with ~~section 600~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***,<sup>fn 11</sup> and the group auditor has obtained sufficient knowledge in connection with the group audit about matters in the other information relating to the ~~significant~~ component with respect to which the ***referred-to component*** auditor has performed an audit of the financial statements.

<sup>fn11</sup> Paragraph 50.4 of ~~section 600~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No further amendment to AU-C section 720.]

***Amendment to SAS No. 145, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AICPA, Professional Standards, AU-C sec. 315)***

20. The amendment to SAS No. 145 is effective for audits of financial statements for periods beginning on or after December 15, 2025.

***AU-C section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement***

[No amendment to paragraphs .01–.A16.]

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<sup>fn 11</sup> Paragraph ~~24~~ ***50.4*** of ~~section 600~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** .

### **Risk Assessment Procedures and Related Activities (Ref: par. 13–18)**

**A17.** The risks of material misstatement to be identified and assessed include both those due to fraud and those due to error, and both are covered by this SAS. However, the significance of fraud is such that further requirements and guidance are included in AU-C section 240 in relation to risk assessment procedures and related activities to obtain information that is used to identify and assess the risks of material misstatement due to fraud.<sup>fn 19</sup> In addition, the following AU-C sections provide further requirements and guidance on identifying and assessing risks of material misstatement regarding specific matters or circumstances:

- AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*, with regard to accounting estimates
- AU-C section 550, *Related Parties*, with regard to related party relationships and transaction
- AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, with regard to going concern
- ~~AU-C section 600~~, ***Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***, with regard to group financial statements

<sup>fn 19</sup> [Footnote omitted for purposes of this proposed SAS.]

[No amendment to paragraphs A18–A52.]

**A53.** When an engagement is carried out by a large engagement team, such as for an audit of group financial statements, it is not always necessary or practical for the discussion to include all members in a single discussion (for example, in a multi-location audit), nor is it necessary for all the members of the engagement team to be informed of all the decisions reached in the discussion. The engagement partner may discuss matters with key members of the engagement team, including, if considered appropriate, those with specific skills or knowledge and those ~~responsible for the~~ **performing work at audits of** components, while delegating discussion with others, taking into account the extent of communication considered necessary throughout the engagement team. A communications plan, agreed to by the engagement partner, may be useful.

[No amendment to paragraphs A54-A246.]

### **Identifying and Assessing the Risks of Material Misstatement**

...

#### ***Assessing Risks of Material Misstatement at the Assertion Level***

...

### *Significant Risks*

#### Why Significant Risks Are Determined and the Implications for the Audit

**A247.** The determination of significant risks allows for the auditor to focus more attention on those risks that are close to the upper end of the spectrum of inherent risk, through the performance of certain required responses, including the following:

...

- ~~Section 600~~ ***Proposed SAS Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** requires *the group auditor to evaluate the appropriateness of the design and performance of further audit procedures for areas of higher assessed risks of material misstatement of the group financial statements, or significant risks, on which a component auditor is determining the further audit procedures to be performed* ~~more involvement by the group engagement partner if the significant risk relates to a component in a group audit and for the group engagement team to direct the work required at the component by the component auditor.~~<sup>fn 65</sup>

<sup>fn 65</sup> Paragraphs ~~.57–.58~~ **.42** of ~~AU-C section 600~~, ***Proposed (SAS) Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

[No further amendment to AU-C section 315.]

### **Proposed Statement on Quality Management Standards—Quality Management (AICPA, Professional Standards, QM sec. 10)<sup>1</sup>**

#### ***Proposed Statement on Quality Management Standards (SQMS) No. 1, A Firm’s System of Quality Management***

**21.** The amendment to proposed SQMS No. 1 is effective for systems of quality management designed and implemented by December 15, 2025, and for evaluations of the system of quality management performed by December 15, 2025.

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<sup>1</sup> Proposed Statement on Quality Management Standards (SQMS) No. 1, *A Firm’s System of Quality Management*, has not been finalized. It is expected that it will be issued as a final standard in 2022. The content of the paragraphs in SQMS No. 1 that are shown here may change by the time the proposed SQMS is issued as a final standard.

[No amendment to paragraphs .01–.A67]

**Acceptance and Continuance of Client Relationships and Specific Engagements**

***The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client (Ref: par. 31a(i))***

...

**A68.** ~~AU-C section 600~~<sup>6</sup> ***Proposed Statement on Auditing Standards Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** states that when component auditors are not subject to the AICPA code, compliance 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.<sup>7</sup> Procedures the firm may use regarding the fulfillment of relevant ethical requirements that apply to them by network firms, employees of network firms, or service providers may include confirmations, letters of representation, or other affirmations.

6 Paragraph ~~A46.A56~~ of ~~AU-C section 600~~; ***Proposed Statement on Auditing Standards Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)***.

7 The section, “Application of the AICPA Code” (ET sec. 0.200.020), of the AICPA Code of Professional Conduct (AICPA code) explains that an AICPA member who is the group engagement partner of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA code, provided that component auditors that are not subject to the AICPA code are in compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics.

[No amendment to paragraphs .A69–A119]

**Information and Communication (Ref: par. 34)**

...

***Communication Within the Firm (Ref: par. 34b–c)***

**A120.** The firm may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the firm and one another by establishing communication channels to facilitate communication across the firm. Examples of communication among the firm, engagement teams, and other individuals include the following:

- ~~The group auditor engagement team~~ communicates matters to component auditors in accordance with the firm’s policies or procedures, including matters related to quality management at the engagement level.

...

[No further amendment to proposed SQMS 1.]

**Proposed Statement on Quality Management Standards No. 2, *Engagement Quality Reviews* (proposed SQMS 2)<sup>2</sup>**

22. The amendment to proposed SQMS 2 is effective for audits or reviews of financial statements for periods beginning on or after December 15, 2025, and other engagements in the firm’s accounting and auditing practice beginning on or after December 15, 2025. An engagement in the firm’s accounting and auditing practice begins when an engagement letter or other agreement to perform attest services is signed, or when the firm begins to perform the engagement, whichever is earlier.<sup>8</sup>

[No amendment to paragraphs 1-A30]

**Performance of the Engagement Quality Review (Ref: par. 24–27)**

...

***Procedures Performed by the Engagement Quality Reviewer (Ref: par. 25–27)***

...

***Group Audit Considerations***

**A31.** The performance of an engagement quality review for an audit of group financial statements may involve additional considerations for the individual appointed as the engagement quality reviewer for the group audit, depending on the size and complexity of the group. Paragraph 21a requires the firm’s policies or procedures to require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review. In doing so, for larger and more complex group audits, the group engagement quality reviewer may need to discuss significant matters and significant judgments with key members of the engagement team other than the group ~~auditor engagement team~~ (for example, ~~those responsible for performing audit procedures on the financial information of a component auditor~~). In these circumstances, the engagement quality reviewer may be assisted by individuals in accordance

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<sup>2</sup> Proposed Statement on Quality Management Standards (SQMS) No. 2, *Engagement Quality Reviews*, has not been finalized. It is expected that it will be issued as a final standard in 2022. The content of the paragraphs in the proposed SQMS that are shown here may change by the time the proposed SQMS is issued as a final standard

with paragraph 20. The guidance in paragraph A22 may be helpful when the engagement quality reviewer for the group audit is using assistants.

[No further amendment to proposed SQMS 2, *Engagement Quality Reviews*.]

**Proposed Statement on Auditing Standards *Quality Management for Engagements Conducted in Accordance With GAAS* (proposed QM SAS)<sup>3</sup>**

23. The amendment to the proposed QM SAS is effective for engagements conducted in accordance with generally accepted auditing standards for periods beginning on or after December 15, 2025.

[No amendment to paragraphs 1-41]

**Scope of This Proposed SAS (Ref: par. 1)**

**A1.** This proposed SAS applies to all audits of financial statements, including audits of group financial statements. ~~AU-C section 600, *Proposed Statement on Auditing Standards (SAS) Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)* addresses deals with~~ special considerations that apply to an audit of group financial statements, including when component auditors are involved *or when the group auditor makes reference to the audit of a referred-to auditor.* ~~AU-C section 600~~ ***Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** also provides guidance on how to adapt and apply the requirements of this proposed SAS in an audit of group financial statements involving component auditors. ~~AU-C section 600~~ ***Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, ~~AU-C section 600~~ ***Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*** may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

[No amendment to paragraphs A2-A20]

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<sup>3</sup> Proposed Statement on Auditing Standards (SAS), *Quality Management for Engagements Conducted in Accordance With GAAS*, has not been finalized. It is expected that it will be issued as a final standard in 2022. The content of the paragraphs in the proposed SAS that are shown here may change by the time the proposed SAS is issued as a final standard.

## Definitions

### *Engagement Team (Ref: par. 12d)*

...

*A21A. When joint auditors conduct an audit, the joint engagement partners and their engagement teams collectively constitute the “engagement partner” and “engagement team” for purposes of GAAS. This proposed QM SAS does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.*

*A21B. Referred-to auditors are not members of the engagement team.* <sup>fn 25</sup>

*Fn 25 Paragraph .A26.1 of Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors).*

[No amendment to paragraphs A22–.A23]

### *The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. 8)*

**A24.** In particular, the firm’s policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm’s recruitment and training processes and, therefore, the firm’s policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. Paragraphs ~~22 26~~ and ~~A47–A48.A59–.A63~~ of **AU-C section 600-Proposed SAS Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** contain guidance on obtaining an understanding of the competence and capabilities of component auditors.
- understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm’s training with regard to the firm’s policies or procedures for relevant ethical requirements. The firm’s policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals, or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement to the individual
- will confirm independence. For example, individuals who are not personnel may not be able to complete independence declarations directly on the firm’s independence systems. The firm’s policies or procedures may state that such individuals can provide evidence of

their independence in relation to the audit engagement in other ways, such as written confirmation.

**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 *auditor engagement team*.

[No amendment to paragraphs A26–.A52]

**Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. 22–24)**

...

A53. Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this proposed SAS and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity’s timetable for reporting, such as at interim and final stages
- In relation to group audits, the nature of the control relationships between the parent and its *entities or business units* ~~components~~
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed

A54. Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other AU-C sections, as well as this proposed SAS, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by AU-C section 210, *Terms of Engagement*<sup>29</sup>
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with AU-C section 315 and AU-C section 240, Consideration of Fraud in a Financial Statement Audit
- Understanding the group, ~~its components~~, and *its* ~~their~~ environments, in the case of an audit of group financial statements in accordance with ~~AU-C section 600~~ **Proposed**

**SAS, Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)** and directing, supervising, and reviewing the work of component auditors

- Determining whether, and how, to involve an auditor’s specialist in accordance with AU-C section 620
- The entity’s governance structure in accordance with AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*, and AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*

...

**Engagement Resources (Ref: par. 25–28)**

...

A60. Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances when the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group *auditor engagement team*.<sup>30</sup> In such circumstances, the firm’s policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available.

30 See paragraph .03 .A10 of AU-C section 600, *Proposed SAS* Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors **and Audits of Referred-to Auditors**).

...

**Insufficient or Inappropriate Resources (Ref: par. 27)**

...

~~A76. In an audit of group financial statements, when there are insufficient or inappropriate resources in relation to work being performed at a component by a component auditor, the engagement partner may discuss the matter with the component auditor, management, or the firm to make sufficient and appropriate resources available.~~

...

**Engagement Performance**

...

***The Engagement Partner’s Review (Ref: par. 30–34)***

...

A92. The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm’s policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

- Matters related to planning the engagement, such as matters related to determining materiality
  - The composition of the engagement team, including
    - personnel using expertise in a specialized area of accounting or auditing
    - the use of personnel from service delivery centers
  - The decision to involve an auditor’s specialist, including the decision to involve an external specialist
- The engagement team's consideration of information obtained in the acceptance and continuance process and proposed responses to that information
- The engagement team's risk assessment process, including situations in which consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team
- The engagement team's consideration of related party relationships and transactions and disclosures
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions concerning certain accounting estimates, accounting policies, or going concern considerations
- The engagement team's evaluation of the work performed by specialists and conclusions drawn therefrom
- In group audit situations
  - the proposed overall group audit strategy and group audit plan;
  - decisions about the involvement of component auditors, including how to direct and supervise them and review their work, ~~including, for example, when there are areas of higher assessed risk of material misstatement of the financial information of a component;~~ and
  - the evaluation of work performed by component auditors and the conclusions drawn therefrom
- How matters affecting the overall audit strategy and audit plan have been addressed
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The proposed audit opinion and matters to be communicated in the auditor’s report, for example, key audit matters, or a “Material Uncertainty Related to Going Concern” paragraph

Agenda Item 2D – Conforming Amendments to Various Statements on Auditing Standards (SAS) to  
Reflect the Proposed Group Audits SAS

[No further amendment to proposed SAS *Quality Management for Engagements Conducted in Accordance With GAAS.*]

**AU-C 935****I. Objective of Agenda Item**

To review and vote to expose proposed Statement on Auditing Standards (SAS) *Amendments to AU-C Section 935*. The proposed SAS proposes amendments to AU-C section 935, *Compliance Audits*, to update AU-C section 935 *Appendix—AU-C Sections That Are Not Applicable to Compliance Audits* and to conform AU-C section 935 for the issuance of the following SASs:

- SAS No. 142, [\*Audit Evidence\*](#) (AU-C sec. 500)
- SAS No. 145, [\*Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement\*](#) (AU-C sec. 315)

**II. AU-C 935 Task Force**

Maria Manasses, *Chair*  
Maxene Bardwell  
Jeanne Dee  
Erica Forhan  
Mandy Nelson  
George Strudgeon

The Task Force is staffed by Ahava Goldman and Teresa Bordeaux, *AICPA Governmental Auditing and Accounting Team*.

**III. Background**

AU-C section 935, *Compliance Audits*, addresses the application of GAAS to a compliance audit. AU-C sections 200–900 address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, certain AU-C sections, or portions thereof, are not applicable to a compliance audit because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in AU-C section 935. These AU-C sections, or specified requirements thereof, are identified in the appendix to AU-C section 935, “AU-C Sections That Are Not Applicable to Compliance Audits” (“the Appendix”).

The AU-C 935 Task Force was charged with proposing amendments to AU-C section 935, *Compliance Audits*, to update the Appendix and conform AU-C section 935 for the issuance of the following SASs:

- SAS No. 142
- SAS No. 143, [\*Auditing Accounting Estimates and Related Disclosures\*](#)
- SAS No. 144, [\*Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources\*](#) (AU-C sec. 540)
- SAS No. 145

#### IV. Task Force Discussion

The Task Force determined that no changes were needed for the issuance of SAS Nos. 143 and 144. SAS No. 143 is codified in AU-C section 540, which is listed in the Appendix as not applicable in its entirety to a compliance audit. SAS No. 144 proposed amendments only to certain application material that is not relevant to AU-C section 935.

##### SAS No. 142

SAS No. 142 superseded AU-C section 500, *Audit Evidence*, and amended other AU-C sections, including AU-C section 501, *Audit Evidence—Specific Considerations for Selected Items*. AU-C section 501 does not apply to a compliance audit. However, these amendments moved what had been paragraph 8 of AU-C section 500, relating to management specialists, to become paragraph 26 of AU-C section 501. This paragraph was applicable to compliance audits when it was in AU-C section 500; that applicability didn't change when it was relocated. Accordingly, the Appendix is proposed to be revised for AU-C section 501 to exclude all paragraphs except paragraph 26.

##### SAS No. 145

- Paragraphs 12c, 26–30, and 33c of extant AU-C section 315 are not applicable to compliance audits. The Appendix was updated to include (and, thereby, exclude from a compliance audit), comparable paragraphs (19b, 20, 32-34, 36, and 42d)
- Paragraphs 27a, which relates to controls over significant risks, and paragraph 40, which relates to classes of transactions, account balances, and disclosures that are not significant but are material, were added to the Appendix. Historically, the concept of significant risks has not applied to compliance audits. Likewise, the concept of classes of transactions, account balances, and disclosures that are material is not applicable to compliance audits
- With respect to control activities, extant AU-C section 935 did not exclude controls over journal entries and other adjustments in AU-C section 240. Accordingly, paragraph 27b was not excluded.
- For ease of use, the Task Force excluded paragraphs 35, 37 and 38 of SAS No. 145 by including them in the Appendix and then added those paragraphs, adapted as necessary, as requirements directly in AU-C section 935. Application material was added to AU-C section 935 that references the twenty-two relevant application material paragraphs for paragraphs 35, 37 and 38 in SAS No. 145.
- Extant AU-C section 935 excludes the documentation requirement related to the identified and assessed risks at the financial statement level and assertion level (paragraph 33c of extant AU-C section 315). However, the Task Force believes that this requirement, adapted as necessary, is applicable to a compliance audit. The Task Force has added a new requirement based on paragraph .42d of SAS No. 145, that, consistent with other revisions, excludes significant risks, and has excluded paragraph .42d of SAS No. 145.

##### Other

- There is an inconsistency in extant AU-C section 935 with respect to significant risks: the requirements in AU-C section 315 were scoped out but the requirements in AU-C section 330 were not. This inconsistency has been removed by adding paragraphs 15, 18 and 22 of AU-C section 330 to the Appendix.

Effective Date

SAS No. 142 has an effective date of December 15, 2022. SAS No. 145 has an effective date of December 15, 2023.

The Task Force considered the following three options for the effective date of the proposed SAS:

1. Having all the proposed amendments to AU-C section 935 be effective December 15, 2022. *Con:* Amendments to the requirements of AU-C section 935 that are based on SAS No. 145 would be effective prior to the effective date of SAS No. 145. This option is not viable.
2. Having all the proposed amendments to AU-C section 935 be effective December 15, 2023. *Con:* Paragraph 26 of AU-C section 501 would be incorrectly scoped-out for a period of one year.
3. Having the amendment to the appendix with regard to paragraph 26 of AU-C section 501 (that is, the change to one line in the table in par. A43 of AU-C section 935) be effective December 15, 2022, and all the other amendments to AU-C section 935 be effective December 15, 2023. These effective dates align with SAS No. 142 and SAS No. 145, respectively. *Con:* This approach may be difficult to communicate clearly.

Having confirmed with AICPA Content Management that option 3 was practicable, the Task Force took that approach. See paragraph .A43

**IV. Agenda Items Presented:**

- **Item 3A** AU-C section 935, marked for proposed amendments
- **Item 3B** Proposed Exposure Draft, *Amendments to AU-C section 935*

Ms. Manasses will use Agenda item 3A in leading the discussion.

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## AU-C Section 935

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### *Compliance Audits*

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(Supersedes SAS No. 74.)

Source: SAS No. 117; SAS No. 122; SAS No. 123; SAS No. 125; SAS No. 130; SAS No. 140.

Effective for compliance audits for fiscal periods ending on or after June 15, 2010, unless otherwise indicated. Earlier application is permitted.

#### Introduction and Applicability

.01 Governments frequently establish governmental audit requirements for entities to undergo an audit of their compliance with applicable compliance requirements. This section is applicable when an auditor is engaged, or required by law or regulation, to perform a compliance audit in accordance with all of the following:

- Generally accepted auditing standards (GAAS)
- The standards for financial audits under *Government Auditing Standards*
- A governmental audit requirement that requires an auditor to express an opinion on compliance (Ref: [par. .A1–.A2](#))

.02 This section addresses the application of GAAS to a compliance audit. Compliance audits usually are performed in conjunction with a financial statement audit. This section does not apply to the financial statement audit component of such engagements. Although certain AU-C sections are not applicable to a compliance audit, as identified in the [appendix](#) “AU-C Sections That Are Not Applicable to Compliance Audits,” all AU-C sections other than this section are applicable to the audit of financial statements performed in conjunction with a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

.03 This section is not applicable when the governmental audit requirement calls for an examination, in accordance with Statements on Standards for Attestation Engagements, of an entity’s compliance with specified requirements or an examination of an entity’s internal control over compliance. AT-C section 315, *Compliance Attestation*, is applicable to an examination of an entity’s compliance with specified requirements and AT-C section 205, *Examination Engagements*, is applicable to an examination of an entity’s internal control over compliance. If the entity is required to undergo a compliance audit and an examination of internal control over compliance, this section is applicable to performing and reporting on the compliance audit, and AT-C section 205 is applicable to performing and reporting on the examination of internal control over

compliance. (Ref: [par. .A2](#)) [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18.]

- .04 Sections 200–900 address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, those AU-C sections, or portions thereof, identified in the appendix cannot be adapted to a compliance audit because they address the matters that are not applicable to a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]
- .05 Except for the AU-C sections that are listed in the [appendix](#) as not applicable to a compliance audit, all of the other AU-C sections are applicable to a compliance audit. However, the auditor is not required, in planning and performing a compliance audit, to make a literal translation of each procedure that might be performed in a financial statement audit, but rather to obtain sufficient appropriate audit evidence to support the auditor’s opinion on compliance. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]
- .06 Some AU-C sections can be adapted and applied to a compliance audit with relative ease, for example, by simply replacing the word *misstatement* with the word *noncompliance*. Other AU-C sections are more difficult to adapt and apply and entail additional modification. For that reason, this section provides more specific guidance on how to adapt and apply certain AU-C sections to a compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]
- .07 *Government Auditing Standards* and governmental audit requirements contain certain standards and requirements that are supplementary to those in GAAS, as well as guidance on how to apply those standards and requirements.

#### **Management’s Responsibilities**

- .08 A compliance audit is based on the premise that management is responsible for the entity’s compliance with compliance requirements. Management’s responsibility for the entity’s compliance with compliance requirements includes the following:
  - a. Identifying the entity’s government programs and understanding and complying with the compliance requirements
  - b. Designing, implementing, and maintaining effective controls that provide reasonable assurance that the entity administers government programs in compliance with the compliance requirements
  - c. Evaluating and monitoring the entity’s compliance with the compliance requirements

- d. Taking corrective action when instances of noncompliance are identified, including corrective action on audit findings of the compliance audit

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

#### Effective Date

- .09 The provisions of this section are effective for compliance audits for fiscal periods ending on or after June 15, 2010. Earlier application is permitted.

#### Objectives (Ref: [par. .A3](#))

- .10 The auditor's objectives in a compliance audit are to
  - a. obtain sufficient appropriate audit evidence to form an opinion and report at the level specified in the governmental audit requirement about whether the entity complied in all material respects with the applicable compliance requirements; and
  - b. identify audit and reporting requirements specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards*, if any, and perform procedures to address those requirements.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

#### Definitions

- .11 For purposes of adapting GAAS to a compliance audit, the following terms have the meanings attributed as follows:

**Applicable compliance requirements.** Compliance requirements that are subject to the compliance audit.

**Audit findings.** The matters that are required to be reported by the auditor in accordance with the governmental audit requirement.

**Audit risk of noncompliance.** The risk that the auditor expresses an inappropriate audit opinion on the entity's compliance when material noncompliance exists. Audit risk of noncompliance is a function of the risks of material noncompliance and detection risk of noncompliance.

**Compliance audit.** A program-specific audit or an organization-wide audit of an entity's compliance with applicable compliance requirements.

**Compliance requirements.** Laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to a government program with which the entity is required to comply.

**Deficiency in internal control over compliance.** A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A deficiency in *design* exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in *operation* exists when a properly designed control does not operate as designed or the person performing the control does not possess the necessary authority or competence to perform the control effectively.

**Detection risk of noncompliance.** The risk that the procedures performed by the auditor to reduce audit risk of noncompliance to an acceptably low level will not detect noncompliance that exists and that could be material, either individually or when aggregated with other instances of noncompliance.

**Government Auditing Standards.** Standards and guidance issued by the Comptroller General of the United States, U.S. Government Accountability Office for financial audits, reviews of financial statements, attestation engagements, and performance audits. *Government Auditing Standards* also is known as generally accepted government auditing standards (GAGAS) or the Yellow Book.

**Government program.** The means by which governmental entities achieve their objectives. For example, one of the objectives of the U.S. Department of Agriculture is to provide nutrition to individuals in need. Examples of government programs designed to achieve that objective are the Supplemental Nutrition Assistance Program and the National School Lunch Program. Government programs that are relevant to this section are those in which a grantor or pass-through entity provides an award to another entity, usually in the form of a grant, contract, or other agreement. Not all government programs provide cash assistance; sometimes noncash assistance is provided (for example, a loan guarantee, commodities, or property).

**Governmental audit requirement.** A government requirement established by law, statute, regulation, rule, or provision of contracts or grant agreements requiring that an entity undergo an audit of its compliance with applicable compliance requirements related to one or more government programs that the entity administers. (Ref: [par. .A4](#))

**Grantor.** A government agency from which funding for the government program originates.

**Known questioned costs.** Questioned costs specifically identified by the auditor.  
Known questioned costs are a subset of likely questioned costs.

**Likely questioned costs.** The auditor's best estimate of total questioned costs, not just the known questioned costs. Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

**Material noncompliance.** In the absence of a definition of material noncompliance in the governmental audit requirement, noncompliance with the applicable compliance requirements is considered quantitatively or qualitatively material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the government program as a whole.

**Material weakness in internal control over compliance.** A deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. In this section, a reasonable possibility exists when the likelihood of an event occurring is either reasonably possible or probable as defined as follows:

**Reasonably possible.** The chance of the future event or events occurring is more than remote but less than likely.

**Probable.** The future event or events are likely to occur.

**Organization-wide audit.** An audit of an entity's financial statements and an audit of its compliance with the applicable compliance requirements as they relate to one or more government programs that the entity administers.

**Pass-through entity.** An entity that receives an award from a grantor or other entity and distributes all or part of it to another entity to administer a government program.

**Program-specific audit.** An audit of an entity's compliance with applicable compliance requirements as they relate to one government program that the entity administers. The compliance audit portion of a program-specific audit is performed in conjunction with either an audit of the entity's or the program's financial statements.

**Questioned costs.** Costs that are questioned by the auditor because (1) of a violation or possible violation of the applicable compliance requirements, (2) the costs are not supported by adequate documentation, or (3) the incurred costs appear

**Commented [MM1]: Note:** While we made certain revisions in SAS 145 with regard to "reasonably possible" and "probable," we did not revise this language in AU-C 265. Accordingly, no changes are proposed to AU-C 935.

unreasonable and do not reflect the actions that a prudent person would take in the circumstances.

**Risk of material noncompliance.** The risk that material noncompliance exists prior to the audit. This consists of two components, described as follows:

**Inherent risk of noncompliance.** The susceptibility of a compliance requirement to noncompliance that could be material, either individually or when aggregated with other instances of noncompliance, before consideration of any related controls over compliance.

**Control risk of noncompliance.** The risk that noncompliance with a compliance requirement that could occur and that could be material, either individually or when aggregated with other instances of noncompliance, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control over compliance.

**Significant deficiency in internal control over compliance.** A deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

## Requirements

### Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: [par. .A5](#) and [.A40](#))

.12 When performing a compliance audit, the auditor, using **exercising** professional judgment, should adapt and apply the AU-C sections to the objectives of a compliance audit, except for the AU-C sections listed in the [appendix](#). [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

### Establishing Materiality Levels (Ref: [par. .A6–A8](#))

.13 The auditor should establish and apply materiality levels for the compliance audit based on the governmental audit requirement.

### Identifying Government Programs and Applicable Compliance Requirements (Ref: [par. .A9–A11](#))

.14 As discussed in [paragraph .08](#), a compliance audit is based on the premise that management is responsible for identifying the entity's government programs and understanding and complying with the compliance requirements. The auditor should determine which of

**Commented [MM2]: Note:** No significant revisions were made to these definition in AU-C 200. Also, this AU-C intentionally refers to "internal control over compliance" in lieu of the "entity's system of internal control." Accordingly, no changes are proposed to AU-C 935.

**Commented [AG3]: Note:** To be consistent with AU-C section 200; no performance difference intended.

those government programs and compliance requirements to test (that is, the applicable compliance requirements) in accordance with the governmental audit requirement.

**Performing Risk Assessment Procedures (Ref: [par. .A12–.A15](#))**

- .15** For each of the government programs and applicable compliance requirements selected for testing, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the applicable compliance requirements and the entity’s internal control over compliance with the applicable compliance requirements.<sup>[fn 1]</sup>
- .16** In performing risk assessment procedures, the auditor should inquire of management about whether there are findings and recommendations in reports or other written communications resulting from previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit. The auditor should gain an understanding of management’s response to findings and recommendations that could have a material effect on the entity’s compliance with the applicable compliance requirements (for example, taking corrective action). The auditor should use this information to identify and assess risks of material noncompliance and determine the nature, timing, and extent of the audit procedures for the compliance audit, including determining the extent to which testing the implementation of any corrective actions is applicable to the audit objectives. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**Commented [AG4]: Note:** Revised to refer to comparable paragraphs in SAS 145 and to scope out significant risks (par. 27a). See issues paper.

With respect to control activities, extant AU-C 935 did not scope out controls over journal entries and other adjustments in AU-C 240. Accordingly, paragraph 27b was not scoped out.

Also, there was an inconsistency in AU-C 935 with respect to significant risks (that is, the requirements in AU-C 315 were scoped out but the requirements in AU-C 330 were not). This inconsistency has been corrected herein; historically, significant risks do not apply to compliance audits.

**Identifying and Assessing the Risks of Material Noncompliance (Ref: [par. .A16–.A18A](#))**

- .17** The auditor should identify ~~and assess~~ the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity’s compliance because they may affect the entity’s compliance with many compliance requirements.<sup>[fn 2]</sup> [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**Commented [MM5]: Note:** Paragraphs 32-38 of SAS 145 are scoped out in the appendix and paragraphs 35, 37 and 38, have been brought in, adapted as necessary, to make this section easier to apply.

**Commented [MM6]: Note:** Deleted to align with the new structure and additional requirements.

Assessing Inherent Risk

- .17A** ***For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess inherent risk by assessing the likelihood and magnitude of noncompliance. In doing so, the auditor should take into account how,***

**Commented [AG7]: Note:** SAS 145 par. 35, adapted

<sup>fn 1</sup> Paragraphs ~~.03–.12b~~ and ~~.12d–.25~~, ~~.11–.19a~~, ~~.19c~~, ~~.21–.26~~, ~~.27b–.31~~ of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

<sup>[fn 2]</sup> [Footnote deleted by the issuance of SAS No. 140, April 2020.]

*and the degree to which, inherent risk factors affect the susceptibility of compliance requirements to noncompliance.*

- .17B** *The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material noncompliance.*

Commented [AG8]: Note: SAS 145 par. 37, adapted

Assessing Control Risk

- .17C** *For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess control risk based on the auditor's understanding of controls and the auditor's plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the risk of material noncompliance is the same as the assessment of inherent risk.*

Commented [AG9]: Note: SAS 145 par. 38, adapted

#### Performing Further Audit Procedures in Response to Assessed Risks

- .18** If the auditor identifies risks of material noncompliance that are pervasive to the entity's compliance, the auditor should develop an overall response to such risks. (Ref: [par. .A19](#))
- .19** The auditor should design and perform further audit procedures, including tests of details (which may include tests of transactions) to obtain sufficient appropriate audit evidence about the entity's compliance with each of the applicable compliance requirements in response to the assessed risks of material noncompliance. Risk assessment procedures, tests of controls, and analytical procedures alone are not sufficient to address a risk of material noncompliance. (Ref: [par. .A20–.A23](#))
- .20** The auditor should design and perform further audit procedures in response to the assessed risks of material noncompliance. These procedures should include performing tests of controls over compliance if
- the auditor's risk assessment includes an expectation of the operating effectiveness of controls over compliance related to the applicable compliance requirements;
  - substantive procedures alone ~~do not~~ **cannot** provide sufficient appropriate audit evidence; or
  - such tests of controls over compliance are required by the governmental audit requirement.

Commented [MM10]: Note: To align with paragraph .08 of AU-C 330 and be consistent with the use of "cannot" in paragraphs .37 and .42d of AU-C 315.

If any of the conditions in this paragraph are met, the auditor should test the operating effectiveness of controls over each applicable compliance requirement to which the conditions apply in each compliance audit. (Ref: [par. .A24–.A25](#))

### Supplementary Audit Requirements

- .21 The auditor should determine whether audit requirements are specified in the governmental audit requirement that are supplementary to GAAS and *Government Auditing Standards* and perform procedures to address those requirements, if any. (Ref: [par. .A26](#))
- .22 In instances where audit guidance provided by a governmental agency for the performance of compliance audits has not been updated for, or otherwise conflicts with, current GAAS or *Government Auditing Standards*, the auditor should comply with the most current applicable GAAS and *Government Auditing Standards* instead of the outdated or conflicting guidance. (Ref: [par. .A27](#))

### Written Representations

- .23 The auditor should request from management written representations<sup>fn 3</sup> that are tailored to the entity and the governmental audit requirement: (Ref: [par. .A28](#))
- a. acknowledging management’s responsibility for understanding and complying with the compliance requirements;
  - b. acknowledging management’s responsibility for the design, implementation, and maintenance of controls that provide reasonable assurance that the entity administers government programs in accordance with the compliance requirements;
  - c. stating that management has identified and disclosed to the auditor all of its government programs and related activities subject to the governmental audit requirement;
  - d. stating that management has made available to the auditor all contracts and grant agreements, including amendments, if any, and any other correspondence relevant to the programs and related activities subject to the governmental audit requirement;
  - e. stating that management has disclosed to the auditor all known noncompliance with the applicable compliance requirements or stating that there was no such noncompliance;
  - f. stating whether management believes that the entity has complied with the applicable compliance requirements (except for noncompliance it has disclosed to the auditor);

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<sup>fn 3</sup> See section 580, *Written Representations*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

- g.* stating that management has made available to the auditor all documentation related to compliance with the applicable compliance requirements;
- h.* identifying management’s interpretation of any applicable compliance requirements that are subject to varying interpretations;
- i.* stating that management has disclosed to the auditor any communications from grantors and pass-through entities concerning possible noncompliance with the applicable compliance requirements, including communications received from the end of the period covered by the compliance audit to the date of the auditor’s report;
- j.* stating that management has disclosed to the auditor the findings received and related corrective actions taken for previous audits, attestation engagements, and internal or external monitoring that directly relate to the objectives of the compliance audit, including findings received and corrective actions taken from the end of the period covered by the compliance audit to the date of the auditor’s report;
- k.* stating that management has disclosed to the auditor all known noncompliance with the applicable compliance requirements subsequent to the period covered by the auditor’s report or stating that there were no such known instances; and
- l.* stating that management is responsible for taking corrective action on audit findings of the compliance audit.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- .24** If the auditor determines that it is necessary to obtain additional representations related to the entity’s compliance with the applicable compliance requirements, the auditor should request such additional representations.

#### **Subsequent Events**

- .25** The auditor should perform audit procedures up to the date of the auditor’s report to obtain sufficient appropriate audit evidence that all subsequent events related to the entity’s compliance during the period covered by the auditor’s report on compliance have been identified. (Ref: [par. .A29](#))
- .26** The auditor should take into account the auditor’s risk assessment in determining the nature and extent of such audit procedures, which should include, but are not limited to, inquiring of management about and considering
- relevant internal auditors' reports issued during the subsequent period.
  - other auditors' reports identifying noncompliance that were issued during the subsequent period.

- reports from grantors and pass-through entities on the entity's noncompliance that were issued during the subsequent period.
- information about the entity's noncompliance obtained through other professional engagements performed for that entity.

.27 The auditor has no obligation to perform any audit procedures related to the entity's compliance during the period subsequent to the period covered by the auditor's report. However, if before the report release date, the auditor becomes aware of noncompliance in the period subsequent to the period covered by the auditor's report that is of such a nature and significance that its disclosure is needed to prevent report users from being misled, the auditor should discuss the matter with management and, if appropriate, those charged with governance, and should include an other-matter paragraph in the auditor's report describing the nature of the noncompliance. (Ref: [par. .A30](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

**Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion (Ref: [par. .A31–.A32](#))**

.28 The auditor should evaluate the sufficiency and appropriateness of the audit evidence obtained.<sup>fn 4</sup>

.29 The auditor should form an opinion, at the level specified by the governmental audit requirement, on whether the entity complied in all material respects with the applicable compliance requirements, and report appropriately. In forming an opinion, the auditor should evaluate likely questioned costs, not just known questioned costs, as well as other material noncompliance that, by its nature, may not result in questioned costs.

**Reporting**

***Combined Report on Compliance and Internal Control Over Compliance***

.30 The auditor's combined report on compliance and internal control over compliance should be in writing and include the following:

- Title.* The auditor's report should have a title that clearly indicates that it is the report of an independent auditor.
- Addressee.* The auditor's report should be addressed, as appropriate, based on the circumstances of the engagement.

<sup>fn 4</sup> Paragraphs .27–.29 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

- c. Report on compliance.* The report on compliance should be presented before the report on internal control over compliance and include the heading “Report on Compliance.”
- d. Opinion.* The first section of the auditor’s report on compliance should include the auditor’s opinion and section with a heading that includes the word “Opinion” and indicates the reporting level pursuant to the governmental audit requirement. The “Opinion” section of the auditor’s report should also do the following (Ref: [par. A34](#)):
- i. State that the entity’s compliance with the applicable compliance requirements has been audited
  - ii. Identify the applicable compliance requirements or include a reference to where they can be found
  - iii. Identify the one or more government programs covered by the compliance audit or reference to a separate schedule containing that information
  - iv. Specify the period covered by the report
  - v. When expressing an unmodified opinion, state that, in the auditor’s opinion, the entity complied, in all material respects, with the compliance requirements that are applicable to [*indicate the reporting level pursuant to the governmental audit requirement*] for the [*specify the period covered by the report*]
- e. Basis for opinion.* The auditor’s report on compliance should include a section, directly following the “Opinion” section, with the heading, “Basis for Opinion,” that does the following:
- i. States that the audit of compliance was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the governmental audit requirement
  - ii. Refers to the section of the auditor’s report that describes the auditor’s responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement

- iii. Includes a statement that the auditor is required to be independent of the entity and to meet the auditor's other ethical responsibilities in accordance with the relevant ethical requirements relating to the audit<sup>fn 5</sup>
  - iv. States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion
  - v. States that the compliance audit does not provide a legal determination of the entity's compliance with the applicable compliance requirements
- f. *Management's responsibilities.* The auditor's report on compliance should include a section with the heading "Responsibilities of Management for Compliance." This section of the auditor's report should describe management's responsibility for compliance with the applicable compliance requirements and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the entity's government programs. If the document containing the auditor's report contains a separate statement by management about its responsibility for the applicable compliance requirements, the auditor's report should not include a reference to such statement by management.
- g. *Auditor's responsibilities.* The auditor's report on compliance should include a section with the heading "Auditor's Responsibilities for the Audit of Compliance." This section of the auditor's report should do the following:
- i. State that the objectives of the auditor are to
    - (1) obtain reasonable assurance about whether material noncompliance with the applicable compliance requirements occurred, whether due to fraud or error
    - (2) express an opinion on the entity's compliance with the applicable compliance requirements based on the compliance audit
  - ii. State that reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and the

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<sup>fn 5</sup> See paragraphs .A38–.A39 of section 700, *Forming an Opinion and Reporting on Financial Statements*.  
[Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

governmental audit requirement will always detect material noncompliance when it exists

- iii. State that the risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
- iv. State that noncompliance with the applicable compliance requirements is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about the entity's compliance with the requirements of the government program as a whole
- v. Describe an audit by stating that, in performing an audit in accordance with GAAS, *Government Auditing Standards*, and [insert the name of the governmental audit requirement or program-specific audit guide] the auditor's responsibilities are to
  - (1) exercise professional judgment and maintain professional skepticism throughout the audit.
  - (2) identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the entity's compliance with applicable compliance requirements and performing such other procedures as the auditor considered necessary in the circumstances.
  - (3) obtain an understanding of the entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [*the governmental audit requirement*], but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over compliance. Accordingly, no such opinion is expressed.
- vi. State that the auditor is required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the audit

[<sup>fn 6</sup>]

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[<sup>fn 6</sup>] [Footnote renumbered and deleted by the issuance of SAS No. 140, April 2020.]

- h.* If noncompliance that does not result in a modified opinion but is required to be reported by the governmental audit requirement is identified, the auditor’s report should include an other-matter paragraph, in a separate section with the heading “Other Matter” or another appropriate heading,<sup>fn7</sup> that includes a description of such noncompliance or a reference to a description of such noncompliance in an accompanying schedule. (Ref: [par. .A36](#))
- i.* *Report on Internal Control Over Compliance.* The auditor’s combined report on compliance and internal control over compliance should include a section with the heading “Report on Internal Control Over Compliance” that does the following:
- i.* Includes the definitions of *deficiency in internal control over compliance*, *material weakness in internal control over compliance*, and *significant deficiency in internal control over compliance*.
  - ii.* States that the auditor’s consideration of the entity’s internal control over compliance was for the limited purpose described in the “Auditor’s Responsibilities for the Audit of Compliance” section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Therefore, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified.
  - iii.* Describes any identified material weaknesses and significant deficiencies in internal control over compliance or a reference to an accompanying schedule containing such a description.
  - iv.* If no material weaknesses in internal control over compliance were identified, includes a statement to that effect.
  - v.* States that the audit was not designed for the purpose of expressing an opinion on the effectiveness of the entity’s internal control over compliance. Accordingly, no such opinion is expressed.
- j.* If the criteria used to evaluate compliance are

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<sup>fn7</sup> Paragraph .08 of section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report*. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- i. established or determined by contractual agreement or regulatory provisions that are developed solely for the parties to the agreement or regulatory agency responsible for the provisions or
- ii. available only to the specified parties,

an alert describing the purpose of the auditor's report on compliance and internal control over compliance and that the report is not suitable for any other purpose, as required by [section 905](#), *Alert That Restricts the Use of the Auditor's Written Communication*.<sup>fn 8</sup>

- k. The manual or printed signature of the auditor's firm.
- l. The city and state where the auditor's report is issued.
- m. The date of the auditor's report. The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on compliance, including evidence that management has asserted that it has identified the entity's government programs and has taken responsibility for understanding and complying with the compliance requirements. (Ref: [par. .A35](#))

A combined report on compliance and internal control over compliance is presented in the exhibit "Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (Unmodified Opinion on Compliance; No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)." [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. As amended, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

#### ***Separate Reports on Compliance and Internal Control Over Compliance***

**.31** If the auditor issues separate reports on compliance and internal control over compliance, the separate report on compliance would omit the elements related to internal control over compliance ([paragraph .30i](#)). The separate report on internal control over compliance would omit the elements related to compliance ([paragraph .30c–h](#)) and would include the following additional statements:

<sup>fn 8</sup> See [paragraphs .06a–b, .11](#), and [.A11](#) of section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote added, effective for the auditor's written communications issued on or after December 15, 2012, by SAS No. 125. Footnote renumbered by the issuance of SAS No. 140, April 2020.]

- a. A statement that the auditor audited the entity’s compliance with applicable compliance requirements pertaining to [*identify the government program or programs and the period audited*] and a reference to the auditor’s report on compliance
- b. A statement that the compliance audit was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the governmental audit requirement
- c. A statement that management is responsible for designing, implementing, and maintaining effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to government programs
- d. A statement that in planning and performing the compliance audit, the auditor considered the entity’s internal control over compliance with the applicable compliance requirements to determine the auditing procedures for the purpose of expressing an opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance
- e. A statement that the auditor is not expressing an opinion on internal control over compliance

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. As amended, effective for the auditor’s written communications issued on or after December 15, 2012, by SAS No. 125. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

[.32] [Paragraph deleted by the issuance of SAS No. 140, April 2020.]

.33 The auditor should report noncompliance as well as other matters that are required to be reported by the governmental audit requirement in the manner specified by the governmental audit requirement. If the other matters required to be reported by the governmental audit requirement are not appropriate for the auditor to report on, the auditor should follow [paragraph .39](#). (Ref: [par. .A36](#))

#### ***Other Reporting Considerations***

.34 The auditor should modify the auditor’s opinion on compliance in accordance with section 705, *Modifications to the Opinion in the Independent Auditor’s Report*, if any of the following conditions exist:

- a. The auditor concludes that, based on the audit evidence obtained, material noncompliance with the applicable compliance requirements exists.

- b. The auditor is unable to obtain sufficient appropriate audit evidence to conclude whether material noncompliance with the applicable compliance requirements exists.

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- .35** When noncompliance results in a modified opinion, the “Basis for Opinion” section, with an appropriately modified heading, should include a description of such noncompliance, or a reference to a description of such noncompliance in an accompanying schedule, and a statement that compliance with such requirements is necessary, in the auditor’s opinion, for the entity to comply with the applicable compliance requirements.<sup>fn 9</sup> [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]
- .36** The auditor should modify the report described in [paragraphs .30](#) and [.31](#) when the auditor makes reference to the report of another auditor as the basis, in part, for the auditor’s report. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]
- [.37]** [Paragraph renumbered and deleted by the issuance of SAS No. 140, April 2020.]
- .38** The auditor also should communicate to those charged with governance of the auditor’s responsibilities under GAAS, *Government Auditing Standards*, and the governmental audit requirement, an overview of the planned scope and timing of the compliance audit, and any significant deficiencies and material weaknesses in internal control over compliance that the auditor identified during the compliance audit.<sup>fn 10</sup> <sup>fn 11</sup> (Ref: [par. .A37–.A38](#)) [Revised, October 2011, to reflect conforming changes necessary due to the

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<sup>fn 9</sup> Paragraph .21 of section 705, *Modifications to the Opinion in the Independent Auditor’s Report*. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

<sup>fn 10</sup> See section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently [moved and] renumbered by the issuance of SAS No. 140, April 2020.]

<sup>fn 11</sup> See section 260, *The Auditor’s Communication With Those Charged With Governance*. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

issuance of SAS No. 122. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- .39 Printed forms, schedules, or reports designed or adopted by government agencies with which they are to be filed sometimes contain prescribed wording. If a printed form, schedule, or report requires the auditor to make a statement that the auditor has no basis to make, the auditor should accordingly reword the form, schedule, or report or attach an appropriately worded separate report. (Ref: [par. .A39](#)) [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

**Documentation (Ref: [par. .A40](#))**

- .40 The auditor should document

- [a.](#) the risk assessment procedures performed, including those related to gaining an understanding of internal control over compliance; ~~and~~<sup>fn 12</sup>
- [b.](#) *the identified and assessed risks of material noncompliance, including risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.*

[Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

- .41 The auditor should document the auditor's responses to the assessed risks of material noncompliance, the procedures performed to test compliance with the applicable compliance requirements, and the results of those procedures, including any tests of controls over compliance.<sup>fn 13</sup> [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

- .42 The auditor should document materiality levels and the basis on which they were determined. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

<sup>fn 12</sup> Paragraph ~~.33a-b~~ and ~~.33d~~ .42a-c of section 315. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

<sup>fn 13</sup> Paragraph .30 of section 330. [Footnote revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

**Commented [AG11]:** Note: Extant AU-C 935 excludes the documentation requirement related to the identified and assessed risks at the financial statement level and assertion level but does not include an equivalent requirement. Accordingly, paragraph .42d of SAS 145 has been scoped out and a similar requirement included herein. This new requirement excludes significant risks, consistent with other revisions.

.43 The auditor should document how the auditor complied with the specific governmental audit requirements that are supplementary to GAAS and *Government Auditing Standards*. [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

**Reissuance of the Compliance Report (Ref: [par. .A41–.A42](#))**

.44 If an auditor reissues the auditor’s report, the reissued report should include an other-matter paragraph stating that the report is replacing a previously issued report and describing the reasons why the report is being reissued, and any changes from the previously issued report. If additional procedures are performed to obtain sufficient appropriate audit evidence for all of the government programs being reported on, the auditor’s report date should be updated to reflect the date the auditor obtained sufficient appropriate audit evidence regarding the events that caused the auditor to perform the new procedures. If, however, additional procedures are performed to obtain sufficient appropriate audit evidence for only some of the government programs being reported on, the auditor should dual date the report with the updated report date reflecting the date the auditor obtained sufficient appropriate audit evidence regarding the government programs affected by the circumstances and referencing the government programs for which additional audit procedures have been performed. Reissuance of an auditor-prepared document required by the governmental audit requirement that is incorporated by reference into the auditor’s report is considered to be a reissuance of the report. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

**Application and Other Explanatory Material**

**Introduction and Applicability**

.A1 An example of an engagement to which this section is applicable is an audit performed in accordance with the provisions of Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the Uniform Guidance). This section is applicable because the Uniform Guidance is a governmental audit requirement that requires the auditor to perform a compliance audit in accordance with both GAAS and *Government Auditing Standards* and to express an opinion on compliance. Another example is a department specific requirement such as the U.S. Department of Housing and Urban Development *Audit Requirements Related to Entities Such As Public Housing Agencies, Nonprofit and For-Profit Housing Projects, and Certain Lenders*. An example of an engagement to which this section is not applicable is an engagement performed to satisfy a law or regulation requiring the entity to have an auditor determine whether the entity has spent transportation excise tax monies in accordance with the specific purposes outlined in the law or regulation, but not requiring that the audit be performed in accordance with both GAAS and *Government Auditing Standards*. Such an engagement could be performed under AT-C section 315; AT-C section 205; or AT-C section 215, *Agreed-Upon Procedures Engagements*, depending on the requirements of the government.

Law or regulation will not always indicate which standards to follow. In such cases, professional judgment will be needed to determine, based on the circumstances, the appropriate standards to follow. (Ref: [par. .01](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A2An example of a governmental audit requirement that calls for an examination of an entity’s compliance with specified requirements in accordance with AT-C section 315 is the compliance attestation engagement of third-party servicers included in the U.S. Department of Education’s audit guide *Guide for Audits of Proprietary Schools and For Compliance Attestation Engagements of Third-Party Servicers Administering Title IV Programs*. (Ref: [par. .01](#) and [.03](#)) [Revised, April 2017, to reflect conforming changes necessary due to the issuance of SSAE No. 18. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

#### **Objectives**

.A3Most governmental audit requirements specify that the auditor’s opinion on compliance is at the program level. However, some governmental audit requirements may specify a different level (for example, at the applicable compliance requirement level). (Ref: [par. .10](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

#### **Definitions**

##### ***Governmental Audit Requirement***

.A4Governmental audit requirements also may set forth specific supplementary requirements of the compliance audit (for example, procedures to be performed by the auditor, documentation requirements, the form of reporting, and continuing professional education requirements with which the auditor is required to comply). (Ref: [par. .11](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

##### **Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: [par. .12](#))**

.A5AU-C sections often identify audit procedures and contain examples that are specific to a financial statement audit. The auditor is not expected to adapt or apply all such procedures to the compliance audit, only those that, in the auditor’s professional judgment, are relevant and necessary to meet the objectives of the compliance audit. [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

##### **Establishing Materiality Levels (Ref: [par. .13](#))**

.A6In a compliance audit, the auditor’s purpose for establishing materiality levels is to

- a. determine the nature and extent of risk assessment procedures.
- b. identify and assess the risks of material noncompliance.
- c. determine the nature, timing, and extent of further audit procedures.
- d. evaluate whether the entity complied with the applicable compliance requirements.
- e. report findings of noncompliance and other matters required to be reported by the governmental audit requirement.

**.A7** Generally, for all of the purposes identified in [paragraph .A6](#), the auditor’s consideration of materiality is in relation to the government program as a whole. However, the governmental audit requirement may specify a different level of materiality for one or more of these purposes. For example, the Uniform Guidance states that the auditor’s determination of whether noncompliance is material for the purpose of reporting an audit finding is in relation to a type of compliance requirements identified in the OMB *Compliance Supplement (Compliance Supplement)*. (See [paragraph .A10](#) for further information about the *Compliance Supplement*.) [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**.A8** Because the governmental audit requirement usually is established by the grantors and the auditor’s report on compliance is primarily for their use, the auditor’s determination of materiality usually is influenced by the needs of the grantors. However, in a compliance audit, the auditor’s judgment about matters that are material to users of the auditor’s report also is based on consideration of the needs of users as a group, including grantors.

**Identifying Government Programs and Applicable Compliance Requirements (Ref: [par. .14](#))**

**.A9** Some governmental audit requirements specifically identify the applicable compliance requirements. Other governmental audit requirements provide a framework for the auditor to determine the applicable compliance requirements. For example, the *Compliance Supplement* provides such a framework for compliance audits under the Uniform Guidance. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**.A10** The following are some of the sources an auditor may consult when identifying and obtaining an understanding of the applicable compliance requirements:

- a. The *Compliance Supplement*, which is issued by the OMB, and used in compliance audits under the Uniform Guidance, contains the compliance requirements that typically are applicable to federal government programs, as well as suggested audit procedures when compliance requirements are applicable and have a direct and material effect on the entity’s compliance. Part 7 of the *Compliance Supplement* provides guidance for identifying compliance requirements for programs not included therein.

- b. The applicable program-specific audit guide issued by the grantor agency, which contains the compliance requirements pertaining to the government program and suggested audit procedures to test for compliance with the applicable compliance requirements.

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**.A11** The following are procedures the auditor may perform to identify and obtain an understanding of the applicable compliance requirements if the *Compliance Supplement* or a program-specific audit guide is not applicable:

- a. Reading laws, statutes, regulations, rules, and provisions of contracts or grant agreements that pertain to the government program
- b. Making inquiries of management and other knowledgeable entity personnel (for example, the chief financial officer, internal auditors, legal counsel, compliance officers, or grant or contract administrators)
- c. Making inquiries of appropriate individuals outside the entity, such as
  - i. the office of the federal, state, or local program official or auditor, or other appropriate audit oversight organizations or regulators, about the laws and regulations applicable to entities within their jurisdiction, including statutes and uniform reporting requirements
  - ii. a third-party specialist, such as an attorney
- d. Reading the minutes of meetings of the governing board of the entity being audited
- e. Reading audit documentation about the applicable compliance requirements prepared during prior years' audits or other engagements
- f. Discussing the applicable compliance requirements with auditors who performed prior years' audits or other engagements

The procedures listed in this paragraph also may assist the auditor in obtaining a further understanding of the applicable compliance requirements even when the *Compliance Supplement* or program-specific audit guide is applicable. [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**Performing Risk Assessment Procedures (Ref: [par. .15–.16](#))**

**.A12** Obtaining an understanding of the government program, the applicable compliance requirements, and the entity's internal control over compliance establishes a frame of reference within which the auditor plans the compliance audit and exercises professional

judgment about **identifying and** assessing risks of material noncompliance and responding to those risks throughout the compliance audit.

**Commented [AG12]: Note:** To be consistent with SAS 145; see paragraphs 32 and 34.

**.A13** The nature and extent of the risk assessment procedures the auditor performs may vary from entity to entity and are influenced by factors such as the following:

- The newness and complexity of the applicable compliance requirements
- The auditor’s knowledge of the entity’s internal control over compliance with the applicable compliance requirements obtained in previous audits or other professional engagements
- The nature of the applicable compliance requirements
- The services provided by the entity and how they are affected by external factors
- The level of oversight by the grantor or pass-through entity
- How management addresses findings

**.A14** ~~Performing risk assessment procedures to obtain an understanding of the entity’s internal control over compliance includes an evaluation of the design of controls and whether the controls have been implemented. For purposes of GAAS, the system of~~ internal control consists of the following five interrelated components: ~~the control environment, the entity’s risk assessment process, information and communication systems, control activities, and the entity’s process to~~ monitoring ***the system of internal control, the information system and communication, and control activities.*** <sup>[fn 14]</sup> Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains a detailed discussion of these components. <sup>fn 15</sup> [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

**Commented [MM13]: Note:** Revised to be consistent with SAS 145 (see footnote for specific paragraphs).

***.A14A In adapting and applying the requirements of section 315<sup>fn16</sup>, the auditor is required to perform risk assessment procedures, beyond inquiry, to evaluate whether the following***

<sup>[fn 14]</sup>[Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

<sup>fn 15</sup> Paragraphs ~~15–25, 21–26, 27b–31~~ and appendix **C**, “*Understanding the Entity’s System of Internal Control Components*,” of section 315. [Footnote added to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

*controls that address risks of material noncompliance are effectively designed and determine whether those controls have been implemented:*

- *Controls over journal entries and other adjustments as required by section 240, Consideration of Fraud in a Financial Statement Audit*
- *Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include*
  - *controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, and*
  - *controls that are required to be tested for operating effectiveness by the governmental audit requirement as required by paragraph 20 of this section, and*
- *Other controls that, based on the auditor’s professional judgment, the auditor considers are appropriate to enable the auditor to identify and assess risks of material noncompliance and design further audit procedures.*

*Evaluating whether controls that address risks of material noncompliance are effectively designed and determining whether those controls have been implemented involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material noncompliance as well as establishing that the control exists, and that the entity is using it.*

***Fn 16 Paragraph .27 of section 315.***

.A15 The auditor’s procedures described in [paragraph .16](#), related to understanding how management has responded to findings and recommendations that could have a material effect on the entity’s compliance with the applicable compliance requirements, are performed to assist the auditor in understanding whether management responded appropriately to such findings. Examples of external monitoring include regulatory reviews, program reviews by government agencies or pass-through entities, and grantor reviews. Examples of internal monitoring include reports prepared by the internal audit function and internal quality assessments.

**Identifying and Assessing the Risks of Material Noncompliance (Ref: [par. .17](#))**

.A16 ***Inherent risk*** factors the auditor may consider ***and other considerations*** in identifying and assessing the risks of material noncompliance ~~are~~ *may include the following* as follows:

**Commented [MM14]:** Note: Now that “inherent risk factors” is used in the requirement, adding this term here because of what follows are inherent risk factors.

**Criteria for identifying and assessing risks of material noncompliance identified by the governmental audit requirement as well as related communications from oversight organizations or regulators**

Commented [AG15]: Note: Added at suggestion of Task Force

- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements
- The auditor’s observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements
- The auditor’s assessment of the risks of material misstatement in the financial statement audit

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**.A17** The auditor may find it helpful to consider the relevant application material in section 315, adapted as necessary for a compliance audit, when in identifying and assessing the risks of material noncompliance, ~~the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination.~~<sup>fn17</sup> [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**FN 17:** Paragraphs .A235, .A237-.A244, and .A252-.A263 of section 315. [Subsequent footnotes are renumbered].

**.A18** Examples of situations in which there may be a risk of material noncompliance that is pervasive to the entity’s noncompliance are as follows:

- An entity that is experiencing financial difficulty and for which there is an increased risk that grant funds will be diverted for unauthorized purposes
- An entity that has a history of poor recordkeeping for its government programs

**Performing Further Audit Procedures in Response to Assessed Risks**

**.A19** Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides guidance that may be adapted when developing an

overall response to the risks of material noncompliance.<sup>fn 16</sup> (Ref: [par. .18](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

- .A20** A compliance audit includes designing procedures to detect both intentional and unintentional material noncompliance. The auditor can obtain reasonable, but not absolute, assurance about the entity’s compliance because of factors such as the need for judgment, the use of sampling, the inherent limitations of internal control over compliance with applicable compliance requirements, and the fact that much of the evidence available to the auditor is persuasive rather than conclusive in nature. Also, procedures that are effective for detecting noncompliance that is unintentional may be ineffective for detecting noncompliance that is intentional and concealed through collusion between entity personnel and a third party or among management or employees of the entity. Therefore, the subsequent discovery that material noncompliance with applicable compliance requirements exists does not, in and of itself, evidence inadequate planning, performance, or judgment on the part of the auditor. (Ref: [par. .19](#))
- .A21** An auditor may decide to use audit sampling to obtain sufficient appropriate audit evidence in a compliance audit. Section 530, *Audit Sampling*, discusses the factors to be considered in planning, designing, and evaluating audit samples, including sampling for tests of controls. In addition, the AICPA Audit Guide Government Auditing Standards *and Single Audits* contains guidance on sampling in the context of a compliance audit. (Ref: [par. .19](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]
- .A22** To test for compliance with applicable laws and regulations, tests of details (including tests of transactions) may be performed in the following areas:
- Grant disbursements or expenditures
  - Eligibility files
  - Cost allocation plans
  - Periodic reports filed with grantor agencies (Ref: [par. .19](#))
- .A23** The use of *substantive* analytical procedures to gather substantive *obtain* evidence *in responding to assessed risks of material noncompliance* is generally less effective in a compliance audit than it is in a financial statement audit. However, substantive analytical

**Commented [MM16]:** Note: SAS 142 does not use the term “substantive evidence.” Revised to clarify this statement in the context of substantive analytical procedures.

<sup>fn 16</sup> Paragraphs .A1–.A3 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

procedures may contribute some evidence when performed in addition to tests of transactions and other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence. (Ref: [par. .19](#))

- .A24** Section 330 provides guidance related to designing and performing further audit procedures in response to the assessed risks of material noncompliance.<sup>fn 17</sup> However, the paragraphs in section 330 that address the use of audit evidence about the operating effectiveness of controls obtained in prior audits are not applicable to a compliance audit.<sup>fn 18</sup> (Ref: [par. .20](#)) [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]
- .A25** Some governmental audit requirements, for example, in the Uniform Guidance, require tests of the operating effectiveness of controls identified as likely to be effective, even if the auditor believes that such testing would be inefficient. (Ref: [par. .20](#)) [As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

#### Supplementary Audit Requirements

- .A26** Examples of supplementary audit requirements are the requirements in the Uniform Guidance for the auditor to
- perform specified procedures to identify major programs.
  - follow up on prior audit findings and perform procedures to assess the reasonableness of the summary schedule of prior audit findings. (Ref: [par. .21](#))

[As amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- .A27** When there is conflicting guidance, the auditor may decide to consult with the government agency responsible for establishing audit guidance or that provides the funding. (Ref: [par. .22](#))

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<sup>fn 17</sup> Paragraphs .06–.12, .15–.18, and .22–.25 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

<sup>fn 18</sup> Paragraph .13–.14 of section 330. [Footnote added, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

### Written Representations

- .A28 -In some cases, management may include qualifying language in the written representations to the effect that representations are made to the best of management’s knowledge and belief. However, such qualifying language is not appropriate for the representations in [paragraph .23a–b](#) and [.23l](#). (Ref: [par. .23](#))

### Subsequent Events

- .A29 Two types of subsequent events may occur. The first type consists of events that provide additional evidence with respect to conditions that existed at the end of the reporting period that affect the entity’s compliance during the reporting period. The second type consists of events of noncompliance that did not exist at the end of the reporting period but arose subsequent to the reporting period. (Ref: [par. .25](#))
- .A30 An example of a matter of noncompliance that may occur subsequent to the period being audited but before the report release date that may warrant disclosure to prevent report users from being misled is the discovery of noncompliance in the subsequent period of such magnitude that it caused the grantor to stop funding the program. (Ref: [par. .27](#))

### Evaluating the Sufficiency and Appropriateness of the Audit Evidence and Forming an Opinion (Ref: [par. .28–.29](#))

- .A31 In determining whether an entity has materially complied with the applicable compliance requirements, the auditor may consider the following factors:
- a. The frequency of noncompliance with the applicable compliance requirements identified during the compliance audit
  - b. The nature of the noncompliance with the applicable compliance requirements identified
  - c. The adequacy of the entity’s system for monitoring compliance with the applicable compliance requirements and the possible effect of any noncompliance on the entity
  - d. Whether any identified noncompliance with the applicable compliance requirements resulted in likely questioned costs that are material to the government program
- .A32 The auditor’s evaluation of whether the entity materially complied with applicable compliance requirements includes consideration of noncompliance identified by the auditor, regardless of whether the entity corrected the noncompliance after the auditor brought it to management’s attention.

## Reporting

[.A33] [Paragraph deleted by the issuance of SAS No. 125, December 2011.]<sup>[fn 19]</sup>

.A34 An appropriate heading for the “Opinion” section indicates the level specified by the governmental audit requirement. For example, an appropriate heading for reports on compliance audits under the Uniform Guidance would be “Opinion on Each Major Federal Program.” (Ref: [par. .30d](#)) [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A35 Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, requires that, on or before the date of the auditor’s report, the engagement partner, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued.<sup>fn 20</sup> When an engagement quality control review is performed, section 220 requires that the auditor’s report not be released prior to the completion of the engagement quality control review.<sup>fn 21</sup> (Ref: [par. .30m](#)) [Paragraph added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

.A36 If the report is a matter of public record or available for public inspection, removing personally identifiable information in the compliance audit report and findings of noncompliance will reduce the likelihood of sensitive information being disclosed. (Ref: [par. .30k–m](#) and [.33](#)) [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

.A37 *Government Auditing Standards* also requires the auditor to obtain and report views of responsible officials concerning the findings, conclusions, and recommendations included in the auditor’s report as well as any planned corrective actions.<sup>fn 22</sup> (Ref: [par. .38](#))

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<sup>[fn 19]</sup>[Footnote deleted by the issuance of SAS No. 125, December 2011. Footnote subsequently renumbered by the issuance of SAS No. 140, April 2020.]

<sup>fn 20</sup> See paragraph .19 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, for further discussion. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

<sup>fn 21</sup> Paragraph .21 of section 220. [Footnote added, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

<sup>fn 22</sup> See the “*Obtaining and Reporting the Views of Responsible Officials*” section of *Government Auditing Standards*. [Footnote renumbered and revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Footnote renumbered, October 2011, to reflect conforming changes necessary due to the

[Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- .A38** If views of responsible officials are included in the auditor’s report or in an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor’s report, the auditor may add a paragraph to the auditor’s written communication disclaiming an opinion on management’s response. Following is an example of such a paragraph: (Ref: [par. .38](#))

*Government Auditing Standards* requires the auditor to perform limited procedures on Example Entity’s response, described in the accompanying [*insert name of document*], to the [*insert type of findings, such as noncompliance or internal control over compliance*] findings identified in our compliance audit. Example Entity’s response was not subjected to the other auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

[Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- .A39** If the auditor is submitting a reworded form, schedule, or report or appropriately worded separate report, the auditor may include a separate communication to the agency explaining why the auditor’s report was modified. (Ref: [par. .39](#)) [Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

**Documentation (Ref: [par. .12](#) and [.40–.43](#))**

- .A40** The auditor is not expected to prepare specific documentation of how the auditor adapted and applied each of the applicable AU-C sections to the objectives of a compliance audit. The documentation of the audit strategy, audit plan, and work performed cumulatively demonstrate whether the auditor has complied with the requirement in [paragraph .12](#). [Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

**Reissuance of the Compliance Report (Ref: [par. .44](#))**

- .A41** The following are examples of situations in which the auditor might reissue the compliance report:

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issuance of SAS No. 123. Footnote subsequently renumbered by the issuance of SAS No. 125, December 2011. Footnote renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

- A quality control review performed by a governmental agency indicates that the auditor did not test an applicable compliance requirement.
- The discovery subsequent to the date of the compliance report that the entity had another government program that was required to be tested.

[Paragraph renumbered by the issuance of SAS No. 140, April 2020.]

**.A42** An example of an auditor-prepared document required by a governmental audit requirement that is incorporated by reference in the auditor’s report is the schedule of findings and questioned costs in a compliance audit under the Uniform Guidance.  
[Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

**Appendix — AU-C Sections That Are Not Applicable to Compliance Audits <sup>[fn 1]</sup>**

**.A43** The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor’s opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
210, <i>Terms of Engagement</i>	Paragraphs .06a and .08a
240, <i>Consideration of Fraud in a Financial Statement Audit</i>	Paragraphs .26 and .32b
250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	All
315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	Paragraphs <del>.19b, .20, .27a, .32-.38, .40, and .42d</del> , <del>.12e, .26-.30, and .33e</del> <u>(effective for compliance audits for fiscal periods ending on or after December 15, 2023)</u>
<del>330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i></del>	Paragraphs <del>.13-.14</del> , <del>15</del> , <del>.18</del> <del>19-24</del> , <del>22</del> , .26, and .31-.32 <u>(effective for compliance audits for fiscal periods ending on or after December 15, 2023)</u>

**Commented [AG17]: Note:** Revised for comparable paragraphs in SAS 145. In addition:  
-Added paragraph .27a of SAS 145 related to controls over significant risks  
-Revised to scope out paragraphs .32 thru .38 of SAS 145 related to identifying and assessing risks (see new paragraphs 17A-17C and revised paragraph 17 herein)  
- Scoped out paragraph .40 of SAS 145 related to classes of transactions, account balances, and disclosures that are not significant but are material

**Commented [AG18]: Note:** To align with effective date of SAS 145, to which this amendment conforms

**Commented [MM19]: Note:** Modified for the following:  
-Address the inconsistency between AU-C 315 and AU-C 330 with regard to significant risks, which includes scoping out paragraphs .15 and .22  
- Scope out the requirement in paragraph .18 to perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure, regardless of the assessed level of control risk.

**Commented [AG20]: Note:** To align with effective date of SAS 145, to which this amendment conforms

<sup>[fn 1]</sup> [Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Agenda Item 3A – AU-C section 935 Conforming Amendments

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
501, <i>Audit Evidence — Specific Considerations for Selected Items</i>	All <u>except paragraph .26 (effective for compliance audits for fiscal periods ending on or after December 15, 2022)</u>
505, <i>External Confirmations</i>	All
510, <i>Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	Paragraphs .06, .08–.13, and .15–.17
540, <i>Auditing Accounting Estimates and Related Disclosures</i>	All
550, <i>Related Parties</i>	All
560, <i>Subsequent Events and Subsequently Discovered Facts</i>	Paragraphs .09–.11 and .19–.20
570, <i>The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern</i>	All
600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	Paragraphs .26, .39, .41c, .41d, .55, and .56c
700, <i>Forming an Opinion and Reporting on Financial Statements</i>	Paragraphs .13–.17, .21–.44, and .45–.61
701, <i>Communicating Key Audit Matters in the Independent Auditor’s Report</i>	All
703, <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>	All
705, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>	Paragraphs .18–.20
706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report</i>	Paragraphs .06–.07
708, <i>Consistency of Financial Statements</i>	All
720B, <i>Other Information in Documents Containing Audited Financial Statements Included in Annual Reports</i>	All
725, <i>Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
730, <i>Required Supplementary Information</i>	All
800, <i>Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	All
805, <i>Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All
806, <i>Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	All
810, <i>Engagements to Report on Summary Financial Statements</i>	All
910, <i>Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	All
915, <i>Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	All

**Commented [AG21]:** Note: To align with effective date of SAS 142, to which this amendment conforms

Agenda Item 3A – AU-C section 935 Conforming Amendments

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<a href="#">920</a> , <i>Letters for Underwriters and Certain Other Requesting Parties</i>	All
<a href="#">925</a> , <i>Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	All
<a href="#">930</a> , <i>Interim Financial Information</i>	All
<a href="#">940</a> , <i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	All
<a href="#">945</a> , <i>Auditor Involvement With Exempt Offering Documents</i>	All

[Revised, January 2011 ~~– August 2012~~, to reflect conforming changes necessary due to the issuance of SAS Nos. 118–120 ~~– Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS Nos. 122 and 123, and 126. Revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 126.~~ As amended, effective for audits for periods ending on or after December 15, 2016, by SAS No. 130; Revised, July 2017, to reflect conforming changes necessary due to the issuance of SAS No. 131. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140. [Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2022 and December 15, 2023, by SAS No 14X.](#)]

**Commented [AM22]:** Proposed edits to condense

**Commented [AG23]:** Note: Proposed wording for codification, not for exposure draft; FYI.

**Exhibit — Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — *(Unmodified Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified)***

.A44 The following is an illustrative combined report on compliance with applicable requirements and internal control over compliance that contains the elements in [paragraph .30](#). This illustrative report contains an unmodified opinion on compliance with no material weaknesses or significant deficiencies in internal control over compliance identified. The AICPA Audit Guide Government Auditing Standards *and Single Audits* contains illustrative language for other types of reports, including reports containing qualified or adverse opinions on compliance with either material weaknesses in internal control over compliance, significant deficiencies in internal control over compliance, or both identified.

**Independent Auditor’s Report**

[*Addressee*]

**Report on Compliance**

**Opinion on [*indicate the reporting level pursuant to governmental audit requirement*]**

We have audited Example Entity's compliance with the *[identify the applicable compliance requirements or refer to the document that describes the applicable compliance requirements]* applicable to Example Entity's *[identify the government program(s) audited or refer to a separate schedule that identifies the program(s)]* for the year ended June 30, 20X1.

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that are applicable to *[indicate the reporting level pursuant to governmental audit requirement]* for the year ended June 30, 20X1.

#### **Basis for Opinion**

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards*<sup>[fn 1]</sup> (*Government Auditing Standards*) issued by the Comptroller General of the United States; and *[insert the name of the governmental audit requirement or program-specific audit guide]*. Our responsibilities under those standards and *[insert the name of the governmental audit requirement or program-specific audit guide]* are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Example Entity and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with the compliance requirements referred to above.

#### **Responsibilities of Management for Compliance**

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the Example Entity's government programs.

#### **Auditor's Responsibilities for the Audit of Compliance**

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Example Entity's compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and *[insert the name of the governmental audit requirement or program-specific audit guide]* will always detect material noncompliance

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<sup>[fn 1]</sup> [Footnote deleted by the issuance of SAS No. 140, April 2020.]

when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Example Entity's compliance with the requirements of the government program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and [insert the name of the governmental audit requirement or program-specific audit guide], we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding Example Entity's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of Example Entity's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with [insert the name of the governmental audit requirement or program-specific audit guide], but not for the purpose of expressing an opinion on the effectiveness of Example Entity's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

### **Report on Internal Control Over Compliance**

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. A *material weakness* in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a

material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that ~~have~~ *were* not been identified.

**Commented [AG24]:** Note: To be consistent with requirement in par 30 (i)iii

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the [*insert the name of the governmental audit requirement or program-specific audit guide*]. Accordingly, this report is not suitable for any other purpose.

[*Signature of the auditor's firm*]  
[*City and state where the auditor's report is issued*]  
[*Date of the auditor's report*]

[Revised, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122. Revised, April 2013, to reflect conforming changes necessary due to the issuance of SAS No. 125. Paragraph renumbered and amended, effective for compliance audits for fiscal periods ending on or after December 15, 2021, by SAS No. 140.]

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# EXPOSURE DRAFT

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## PROPOSED STATEMENT ON AUDITING STANDARDS

### ***AMENDMENTS TO AU-C SECTION 935***

*(Amends Statement on Auditing Standards [SAS] No. 117, Compliance Audits, as amended [AICPA, Professional Standards, AU-C sec. 935])*

**Month Day, 2022**

**Comments are requested by [60 days later]**

**Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.**

**Comments should be submitted in Word format and sent to [CommentLetters@aicpa-cima.com](mailto:CommentLetters@aicpa-cima.com).**

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## Explanatory Memorandum

### Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *Amendments to AU-C Section 935*.<sup>1</sup> If issued as final, the proposed SAS will amend SAS No. 117, *Compliance Audits*, as amended (AICPA, *Professional Standards*, AU-C sec. 935).

### Background

AU-C section 935, *Compliance Audits*, addresses the application of GAAS to a compliance audit. AU-C sections 200–900 address audits of financial statements, as well as other kinds of engagements. Generally, these AU-C sections can be adapted to the objectives of a compliance audit. However, certain AU-C sections, or portions thereof, are not applicable to a compliance audit because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in AU-C section 935. These AU-C sections, or specified requirements thereof, are identified in the appendix to AU-C section 935, “AU-C Sections That Are Not Applicable to Compliance Audits” (“the Appendix”).

This exposure draft proposes amendments to AU-C section 935, *Compliance Audits*, to update the Appendix and conform AU-C section 935 for the issuance of the following SASs:

- SAS No. 142, *Audit Evidence* (AU-C sec. 500)
- SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AU-C sec. 315)

The ASB has determined that no amendments are necessary to AU-C section 935 for the issuance of the following SASs:

- SAS No. 143, *Auditing Accounting Estimates and Related Disclosures* (AU-C sec. 540)
- SAS No. 144, *Amendments to AU-C Sections 501, 540, and 620 Related to the Use of Specialists and the Use of Pricing Information Obtained From External Information Sources*

SAS No. 143 is codified in AU-C section 540, which is listed in the Appendix as not applicable in its entirety to a compliance audit. SAS No. 144 proposed amendments only to certain application material that is not relevant to AU-C section 935.

### Effective Date

If issued as final, the proposed amendment to the Appendix with regard to AU-C section 501, *Audit Evidence—Specific Considerations for Selected Items*, would be effective for compliance audits for fiscal periods ending on or after December 15, 2022. All other proposed amendments in

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<sup>1</sup> All AU-C sections can be found in AICPA *Professional Standards*.

this proposed SAS would be effective for compliance audits for fiscal periods ending on or after December 15, 2023. Early implementation is permitted.

See the discussion of the effective date in “Explanation of Proposed Changes” section below.

## **Explanation of Proposed Changes**

### *Proposed Revisions Arising from SAS No. 142*

SAS No. 142 superseded AU-C section 500, *Audit Evidence*, and amended other AU-C sections, including AU-C section 501, *Audit Evidence—Specific Considerations for Selected Items*. AU-C section 501 does not apply to a compliance audit. However, the amendments moved what had been paragraph 8 of AU-C 500, relating to management specialists, to become paragraph 26 of AU-C 501. This paragraph was applicable to compliance audits when it was in AU-C 500; that applicability didn’t change when it was relocated. Accordingly, the Appendix is proposed to be revised for AU-C section 501 to exclude all paragraphs except paragraph 26.

### *Proposed Revisions Arising from SAS No. 145*

- Paragraphs 12c, 26–30, and 33c of extant AU-C section 315 are not applicable to compliance audits. The Appendix was updated to include (and, thereby, exclude from a compliance audit) comparable paragraphs (19b, 20, 32-34, 36, and 42d) of SAS No. 145
- Paragraphs 27a of SAS No. 145, which relates to controls over significant risks, and paragraph 40, which relates to classes of transactions, account balances, and disclosures that are not significant but are material, were added to the Appendix. Historically, the concept of significant risks has not been applicable to compliance audits. Likewise, the concept of classes of transactions, account balances, and disclosures that are material is not applicable to compliance audits.
- With respect to control activities, extant AU-C section 935 did not exclude controls over journal entries and other adjustments in AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*. Accordingly, paragraph 27b of SAS No. 145 was not excluded.
- For ease of use, paragraphs 35, 37 and 38 of SAS No. 145, adapted as necessary, were added as requirements directly in AU-C section 935 and, consequentially, listed in the Appendix as not applicable when applying AU-C section 315 to compliance audits. Application material was added to AU-C section 935 that references the twenty-two relevant application material paragraphs for paragraphs 35, 37 and 38 in SAS No. 145.
- Extant AU-C section 935 excludes the documentation requirement related to the identified and assessed risks at the financial statement level and assertion level (paragraph 33c of extant AU-C 315). The ASB believes that this requirement, adapted as necessary, is applicable to a compliance audit, and has added a new requirement based on paragraph .42d of SAS No. 145, which, consistent with other revisions, excludes significant risks. Accordingly, paragraph .42d of SAS No. 145 has been excluded.

### *Other Proposed Revisions*

- There is an inconsistency in extant AU-C section 935 with respect to significant risks: the requirements in AU-C section 315 were scoped out but the requirements in AU-C section

330 were not. This inconsistency has been removed by adding paragraphs 15, 18 and 22 of AU-C section 330 to the Appendix.

### *Effective Date*

SAS 145 is effective for audits of financial statements for periods ending on or after December 15, 2023. The amendments relating to the application of SAS No. 145 in a compliance audit cannot be effective before the effective date of SAS No. 145.

SAS No. 142 is effective for audits of financial statements for periods ending on or after December 15, 2022. As described above, SAS No. 142 relocated a requirement applicable to compliance audits from AU-C section 500 to AU-C section 501. This necessitated an amendment to the Appendix relating to AU-C section 501. That amendment needs to have the same effective date as SAS No. 142 to retain that requirement as applicable to compliance audits. If the effective date is a year later, paragraph 26 of AU-C section 501 would be incorrectly not applicable to compliance audits for a period of one year.

### **Request for Comment**

1. Are the proposed amendments to AU-C section 935 appropriate and complete, including the proposed amendments to the Appendix?
2. Is the effective date of the proposed amendment clear? If not, please suggest specific revisions.

### **Guide for Respondents**

Respondents are asked to comment on the proposed changes, and whether they are consistent with SAS Nos. 142 and 145.

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, when appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for on the AICPA's website after MONTH DAY, 2022 until a final standard is issued. Responses should be sent to [commentletters@aicpa-cima.com](mailto:commentletters@aicpa-cima.com), and received by MONTH DAY, 2022. Responses may be submitted in Word format or directly in the body of the email with an appropriate signature (name, firm). Respondents may also submit a PDF version of their Word document for posting to the AICPA website.

### **Comment Period**

The comment period for this exposure draft ends MONTH DAY, 2022.

**Auditing Standards Board  
(2021–2022)**

Tracy W. Harding, *Chair*  
Brad C. Ames  
Maxene M. Bradwell  
Patricia Bottomly  
Samantha Bowling  
Sherry Chesser  
Harry Cohen  
Jeanne M. Dee  
Horace Emery  
Diane Hardesty

Robert R. Harris  
Kathleen K. Healy  
Jon Heath  
Clay Huffman  
Greg Jenkins  
Maria C. Manasses  
Andrew Prather  
Chris Rogers  
Tania DeSilva Sergott

**AU-C Section 935 Task Force**

Maria C. Manasses, *Chair*  
Maxene Bardwell  
Jeanne M. Dee

Erica Forhan  
Amanda E. Nelson  
George Strudgeon

**AICPA Staff**

Jennifer Burns, CPA  
*Chief Auditor*  
*Professional Standards and Services*

Ahava Goldman  
*Associate Director*  
*Audit and Attest Standards —*  
*Public Accounting*

## PROPOSED STATEMENT ON AUDITING STANDARDS

### AMENDMENTS TO AU-C SECTION 935

(*Boldface italics* denotes new language. Deleted text is shown in ~~strikethrough~~.)

#### Amendment to AU-C Section 935, *Compliance Audits*

*Boldface italic* denotes new language. Deleted text is in ~~strikethrough~~.

[No amendment to paragraphs .01–.11.]

#### Requirements

##### Adapting and Applying the AU-C Sections to a Compliance Audit (Ref: [par. .A5](#) and [.A40](#))

**.12** When performing a compliance audit, the auditor, ~~using~~ *exercising* professional judgment, should adapt and apply the AU-C sections to the objectives of a compliance audit, except for the AU-C sections listed in the [appendix](#).

[No amendment to paragraphs .13–.14.]

**.15** For each of the government programs and applicable compliance requirements selected for testing, the auditor should perform risk assessment procedures to obtain a sufficient understanding of the applicable compliance requirements and the entity's internal control over compliance with the applicable compliance requirements.<sup>fn 1</sup>

<sup>n1</sup> Paragraphs ~~.03–.12b~~ and ~~.12d–.25.11–.19a, .19c, .21–.26, .27b–.31~~ of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

[No amendment to paragraph .16.]

##### Identifying and Assessing the Risks of Material Noncompliance (Ref: ~~par. .A16–.A18.~~[A19](#))

**.17** The auditor should identify ~~and assess~~ the risks of material noncompliance whether due to fraud or error for each applicable compliance requirement and should consider whether any of those risks are pervasive to the entity's compliance because they may affect the entity's compliance with many compliance requirements.

Assessing Inherent Risk

***.18 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess inherent risk by assessing the likelihood and magnitude of noncompliance. In doing so, the auditor should take into account how, and the degree to which, inherent risk factors affect the susceptibility of compliance requirements to noncompliance.***

***.19 The auditor should determine whether substantive procedures alone cannot provide sufficient appropriate audit evidence for any of the risks of material noncompliance.***

Assessing Control Risk

***.20 For identified risks of material noncompliance for each applicable compliance requirement, the auditor should assess control risk based on the auditor’s understanding of controls and the auditor’s plan to test the operating effectiveness of controls. If the auditor does not plan to test the operating effectiveness of controls, the auditor should assess control risk at the maximum level such that the assessment of the risk of material noncompliance is the same as the assessment of inherent risk.***

[No amendment to paragraphs .18–.19, renumbered as paragraphs .21–.22.]

**~~.20~~<sup>.23</sup> The auditor should design and perform further audit procedures in response to the assessed risks of material noncompliance. These procedures should include performing tests of controls over compliance if**

- the auditor’s risk assessment includes an expectation of the operating effectiveness of controls over compliance related to the applicable compliance requirements;
- substantive procedures alone ~~do not~~**cannot** provide sufficient appropriate audit evidence; or
- such tests of controls over compliance are required by the governmental audit requirement.

If any of the conditions in this paragraph are met, the auditor should test the operating effectiveness of controls over each applicable compliance requirement to which the conditions apply in each compliance audit. (Ref: [par. .A24–.A25](#))

[No amendment to paragraphs .21–.39, renumbered as paragraphs .24–.42.]

**Documentation (Ref: [par. .A40](#))**

**~~.40~~<sup>.43</sup> The auditor should document**

- a.** the risk assessment procedures performed, including those related to gaining an understanding of internal control over compliance; **and** <sup>fn 12</sup>

- b. *the identified and assessed risks of material noncompliance, including risks for which substantive procedures alone cannot provide sufficient appropriate audit evidence, and the rationale for the significant judgments made.*

<sup>fn 12</sup> Paragraph ~~.33a–b~~ and ~~.33d.42a–c~~ of section 315.

[No amendment to paragraphs .41-.44, renumbered as paragraphs .44-.47, and paragraphs .A1-.A12.]

## Application and Other Explanatory Material

[No amendment to paragraphs .A1-.A12.]

### Performing Risk Assessment Procedures (Ref: [par. .15–16](#))

- .A12** Obtaining an understanding of the government program, the applicable compliance requirements, and the entity’s internal control over compliance establishes a frame of reference within which the auditor plans the compliance audit and exercises professional judgment about *identifying and* assessing risks of material noncompliance and responding to those risks throughout the compliance audit.

[No amendment to paragraph .A13.]

- .A14** ~~Performing risk assessment procedures to obtain an understanding of the entity’s internal control over compliance includes an evaluation of the design of controls and whether the controls have been implemented. For purposes of GAAS, the system of i~~Internal control consists of the following five interrelated components: ~~the control environment, the entity’s risk assessment process, information and communication systems, control activities, and the entity’s process to monitoring the system of internal control, the information system and communication, and control activities.~~ Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains a detailed discussion of these components. <sup>fn 15</sup>

<sup>fn 15</sup> Paragraphs ~~.15–.25.21 –.26, .27b-.31~~ and appendix ~~CB~~, “*Understanding the Entity’s System of Internal Control Components*,” of section 315.

- .A15** *In adapting and applying the requirements of section 315<sup>fn16</sup>, the auditor is required to perform risk assessment procedures, beyond inquiry, to evaluate whether the following controls that address risks of material noncompliance are effectively designed and determine whether those controls have been implemented:*

- *Controls over journal entries and other adjustments as required by section 240, Consideration of Fraud in a Financial Statement Audit*
- *Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include*

- *controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence, and*
- *controls that are required to be tested for operating effectiveness by the governmental audit requirement as required by paragraph 20 of this section, and*
- *Other controls that, based on the auditor’s professional judgment, the auditor considers are appropriate to enable the auditor to identify and assess risks of material noncompliance and design further audit procedures.*

*Evaluating whether controls that address risks of material noncompliance are effectively designed and determining whether those controls have been implemented involves considering whether the identified controls, individually or in combination, are capable of effectively preventing, or detecting and correcting, material noncompliance as well as establishing that the control exists, and that the entity is using it.*

*fn 16* Paragraph .27 of section 315.

[Subsequent footnotes are renumbered. No amendment to paragraphs .A15, renumbered as paragraph .A16.]

#### **Identifying and Assessing the Risks of Material Noncompliance (Ref: [par. .17](#))**

~~.A16~~<sup>.17</sup>*Inherent risk* ~~Factors the auditor may consider~~ *and other considerations* in identifying and assessing the risks of material noncompliance ~~are as follows~~ *may include the following:*

- *Criteria for identifying and assessing risks of material noncompliance identified by the governmental audit requirement as well as related communications from oversight organizations or regulators*
- The complexity of the applicable compliance requirements
- The susceptibility of the applicable compliance requirements to noncompliance
- The length of time the entity has been subject to the applicable compliance requirements
- The auditor’s observations about how the entity has complied with the applicable compliance requirements in prior years
- The potential effect on the entity of noncompliance with the applicable compliance requirements
- The degree of judgment involved in adhering to the compliance requirements

- The auditor’s assessment of the risks of material misstatement in the financial statement audit

~~.A1718~~ **The auditor may find it helpful to consider the relevant application material in section 315, adapted as necessary for a compliance audit, when** ~~in identifying and assessing the risks of material noncompliance, the auditor may evaluate inherent risk of noncompliance and control risk of noncompliance individually or in combination.~~<sup>fn17</sup>

***Fn 17 : Paragraphs .A235, .A237-.A244, and .A252-.A263 of section 315. [Subsequent footnotes are renumbered].***

[No amendment to paragraphs .A18-.A22, renumbered as .A19-.A23.]

~~.A2324~~ The use of **substantive** analytical procedures to ~~gather substantive~~ **obtain** evidence **in responding to assessed risks of material noncompliance** is generally less effective in a compliance audit than it is in a financial statement audit. However, substantive analytical procedures may contribute some evidence when performed in addition to tests of transactions and other auditing procedures necessary to provide the auditor with sufficient appropriate audit evidence. (Ref: [par. .19](#))

[No amendment to paragraphs .A24-.A42, renumbered as paragraphs .A25-.A43.]

## Appendix — AU-C Sections That Are Not Applicable to Compliance Audits

~~.A4344~~ The following AU-C sections and individually enumerated requirement paragraphs of specific AU-C sections are not applicable to a compliance audit performed under this section either because (a) they are not relevant to a compliance audit environment, (b) the procedures and guidance would not contribute to meeting the objectives of a compliance audit, or (c) the subject matter is specifically covered in this section. Where the table in this appendix specifies individual requirement paragraphs rather than an entire AU-C section, the application and other explanatory material paragraphs related to such requirement paragraphs also do not apply. However, an auditor may apply these AU-C sections and paragraphs if the auditor believes doing so will provide appropriate audit evidence in the specific circumstances to support the auditor’s opinion on compliance.

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
210, <i>Terms of Engagement</i>	Paragraphs .06a and .08a
240, <i>Consideration of Fraud in a Financial Statement Audit</i>	Paragraphs .26 and .32b

<sup>[fn 1]</sup> [Footnote deleted, October 2011, to reflect conforming changes necessary due to the issuance of SAS No. 122.]

Agenda Item 3B – AU-C section 935 Conforming Amendments

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
250, <i>Consideration of Laws and Regulations in an Audit of Financial Statements</i>	All
315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>	Paragraphs <b>.19b, .20, .27a, .32–.38, .40, and .42d–.42e, .26–.30, and .33e</b> (effective for compliance audits for fiscal periods ending on or after December 15, 2023)
330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>	Paragraphs <del>.13–.14</del> , <b>.15, .18–.21, .22, .26, and .31–.32</b> (effective for compliance audits for fiscal periods ending on or after December 15, 2023)
501, <i>Audit Evidence — Specific Considerations for Selected Items</i>	All except paragraph <b>.26</b> (effective for compliance audits for fiscal periods ending on or after December 15, 2022)
505, <i>External Confirmations</i>	All
510, <i>Opening Balances — Initial Audit Engagements, Including Reaudit Engagements</i>	Paragraphs .06, .08–.13, and .15–.17
540, <i>Auditing Accounting Estimates and Related Disclosures</i>	All
550, <i>Related Parties</i>	All
560, <i>Subsequent Events and Subsequently Discovered Facts</i>	Paragraphs .09–.11 and .19–.20
570, <i>The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern</i>	All
600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>	Paragraphs .26, .39, .41c, .41d, .55, and .56c
700, <i>Forming an Opinion and Reporting on Financial Statements</i>	Paragraphs .13–.17, .21–.44, and .45–.61
701, <i>Communicating Key Audit Matters in the Independent Auditor’s Report</i>	All
703, <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>	All
705, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>	Paragraphs .18–.20
706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report</i>	Paragraphs .06–.07
708, <i>Consistency of Financial Statements</i>	All
720, <i>Other Information Included in Annual Reports</i>	All
725, <i>Supplementary Information in Relation to the Financial Statements as a Whole</i>	All
730, <i>Required Supplementary Information</i>	All
800, <i>Special Considerations — Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>	All
805, <i>Special Considerations — Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement</i>	All
806, <i>Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements</i>	All
810, <i>Engagements to Report on Summary Financial Statements</i>	All

<i>AU-C Section</i>	<i>Paragraphs Not Applicable to Compliance Audits</i>
<a href="#">910</a> , <i>Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country</i>	All
<a href="#">915</a> , <i>Reports on Application of Requirements of an Applicable Financial Reporting Framework</i>	All
<a href="#">920</a> , <i>Letters for Underwriters and Certain Other Requesting Parties</i>	All
<a href="#">925</a> , <i>Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i>	All
<a href="#">930</a> , <i>Interim Financial Information</i>	All
<a href="#">940</a> , <i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	All
<a href="#">945</a> , <i>Auditor Involvement With Exempt Offering Documents</i>	All

**Exhibit — Illustrative Combined Report on Compliance With Applicable Requirements and Internal Control Over Compliance — (*Unmodified Opinion on Compliance, No Material Weaknesses or Significant Deficiencies in Internal Control Over Compliance Identified*)**

.A4445 [Note: amendment is in the third-from-last paragraph below.]

The following is an illustrative combined report on compliance with applicable requirements and internal control over compliance that contains the elements in [paragraph .30](#). This illustrative report contains an unmodified opinion on compliance with no material weaknesses or significant deficiencies in internal control over compliance identified. The AICPA Audit Guide *Government Auditing Standards and Single Audits* contains illustrative language for other types of reports, including reports containing qualified or adverse opinions on compliance with either material weaknesses in internal control over compliance, significant deficiencies in internal control over compliance, or both identified.

**Independent Auditor’s Report**

[Addressee]

**Report on Compliance**

**Opinion on [indicate the reporting level pursuant to governmental audit requirement]**

We have audited Example Entity’s compliance with the [*identify the applicable compliance requirements or refer to the document that describes the applicable compliance requirements*] applicable to Example Entity’s [*identify the government*

*program(s) audited or refer to a separate schedule that identifies the program(s)] for the year ended June 30, 20X1.*

In our opinion, Example Entity complied, in all material respects, with the compliance requirements referred to above that are applicable to *[indicate the reporting level pursuant to governmental audit requirement]* for the year ended June 30, 20X1.

### **Basis for Opinion**

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America (GAAS); the standards applicable to financial audits contained in *Government Auditing Standards*<sup>[fn 1]</sup> (*Government Auditing Standards*) issued by the Comptroller General of the United States; and *[insert the name of the governmental audit requirement or program-specific audit guide]*. Our responsibilities under those standards and *[insert the name of the governmental audit requirement or program-specific audit guide]* are further described in the Auditor’s Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of Example Entity and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide a legal determination of Example Entity's compliance with the compliance requirements referred to above.

### **Responsibilities of Management for Compliance**

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the Example Entity’s government programs.

### **Auditor’s Responsibilities for the Audit of Compliance**

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on Example Entity’s compliance based on our audit. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS, *Government Auditing Standards*, and *[insert the name of the governmental audit requirement or program-specific audit guide]* will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

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<sup>[fn 1]</sup> [Footnote deleted by the issuance of SAS No. 140, April 2020.]

Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgment made by a reasonable user of the report on compliance about Example Entity’s compliance with the requirements of the government program as a whole.

In performing an audit in accordance with GAAS, *Government Auditing Standards*, and *[insert the name of the governmental audit requirement or program-specific audit guide]*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding Example Entity’s compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of Example Entity’s internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with *[insert the name of the governmental audit requirement or program-specific audit guide]*, but not for the purpose of expressing an opinion on the effectiveness of Example Entity’s internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

### **Report on Internal Control Over Compliance**

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance on a timely basis. *A material weakness* in internal control over compliance is a deficiency, or combination of deficiencies in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a compliance requirement will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance. Given these limitations, during our audit we did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, material weaknesses or significant deficiencies in internal control over compliance may exist that ~~have~~*were* not ~~been~~ identified.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the [*insert the name of the governmental audit requirement or program-specific audit guide*]. Accordingly, this report is not suitable for any other purpose.

[*Signature of the auditor's firm*]

[*City and state where the auditor's report is issued*]

[*Date of the auditor's report*]

1. The amendment to paragraph .A43, renumbered as .A44, is effective as indicated in that paragraph. The amendment to all other paragraphs is effective for compliance audits for fiscal periods ending on or after December 15, 2023.

## Quality Management

### I. Objective of Agenda Item

To review proposed revisions to the following proposed standards in response to comments received and prior direction from the Board:

- [Proposed] Statement on Quality Management Standards (SQMS) *A Firm's System of Quality Control (QM 1)*
- [Proposed] SQMS *Engagement Quality Reviews (QM 2)*; and
- [Proposed] Statement on Auditing Standards (SAS) *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*, (collectively the "Proposed QM Standards").

### II. Quality Standards Task Force

The Quality Standards Task Force has been divided into two groups:

#### QM1

Sara Lord, *Chair*  
Sherry Chesser  
Kathryn Fletcher  
Phyllis Anderson  
Alan Long  
Tania Sergott  
Kimberly Stazyk

#### QM2/220

Jon Heath, *Chair*  
Harry Cohen  
Tom Parry  
Jeff Rapaglia  
Rick Reeder  
Mike Westervelt

The Task Force is staffed by Ahava Goldman.

### III. Background

The ASB discussed the issues raised in the Exposure Draft at its October and December meetings. The agenda materials presented for this meeting reflect the direction provided by the ASB at those meetings.

### IV. Task Force Discussion

The Task Forces reviewed the comments from respondents relating to the content and wording of the proposed standards, and proposed certain additional revisions to the proposed standards. No additional issues have been identified from the comment letters.

### IV. Agenda Items Presented:

- **Item 4A** Proposed SQMS 1, marked with suggested revisions
- **Item 4B** Comment Letter Analysis: SQMS 1
- **Item 4C** Proposed SQMS 2, marked with suggested revisions
- **Item 4D** Comment Letter Analysis, SQMS 2
- **Item 4E** Proposed QM SAS with suggested revisions
- **Item 4F** Comment Letter Analysis: QM SAS

Note: Agenda item 4E and 4F were previously provided as agenda items 5B and 5A, respectively, for the ASB's December 2021 meeting. Except for two minor revisions to conform with changes made in the other standards, they are unchanged from the material previously provided.

Agenda Item 4 – Quality Management Standards

Ms. Lord will use agenda items 4A, 4C and 4E in leading the discussion.



## Proposed Statement on Quality Management Standards *A Firm's System of Quality Management*

### Introduction

#### Scope of This Proposed Statement on Quality Management Standards

1. This proposed Statement on Quality Management Standards (SQMS) deals with a firm's responsibilities to design, implement, and operate a system of quality management for its accounting and auditing practice.
2. Engagement quality reviews form part of the firm's system of quality management and
  - a. this proposed SQMS addresses the firm's responsibility to establish policies or procedures addressing engagements that are required to be subject to engagement quality reviews.
  - b. proposed SQMS *Engagement Quality Reviews* deals with the appointment and eligibility of the engagement quality reviewer, and the performance and documentation of the engagement quality review.
- ~~3.~~ Other professional standards include requirements for engagement partners and other engagement team members regarding quality management at the engagement level. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* deals with the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. (Ref: par. A1)
3. Other professional standards, including AT-C section 105, *Concepts Common to All Attestation Engagements*<sup>‡</sup>, and AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*,<sup>1</sup> also establish requirements for the engagement partner for the management of quality at the engagement level.
4. This proposed SQMS is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. Law, regulation, or relevant ethical requirements may establish responsibilities for the firm's management of quality beyond those described in this proposed SQMS. (Ref: par. A2)
5. This proposed SQMS applies to audit and attestation engagements performed by ~~CPA firms~~ firm in accordance with *Government Auditing Standards*. This proposed SQMS does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of *Government Auditing Standards*.

**Commented [AG1]:** Moved from paragraph A1 to give equal prominence to other engagements and not over-emphasize audits. See agenda item 4B row 6

**Commented [AG2]:** For consistency See row 8 of agenda item 4B

<sup>‡</sup> All AT-C sections can be found in *AICPA Professional Standards*.  
<sup>1</sup> All AR-C sections can be found in *AICPA Professional Standards*.

6. This proposed SQMS applies to all firms that perform any engagement included in a firm’s accounting and auditing practice. The system of quality management that is established in accordance with the requirements of this proposed SQMS enables the consistent performance by the firm of all such engagements.

#### The Firm’s System of Quality Management

7. A system of quality management operates in a continual and iterative manner and is responsive to changes in the nature and circumstances of the firm and its engagements. It also does not operate in a linear manner. However, for the purposes of this proposed SQMS, a system of quality management addresses the following eight components: (Ref: par. A3)
  - a. The firm’s risk assessment process
  - b. Governance and leadership
  - c. Relevant ethical requirements
  - d. Acceptance and continuance of client relationships and specific engagements
  - e. Engagement performance
  - f. Resources
  - g. Information and communication
  - h. The monitoring and remediation process
8. This proposed SQMS requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management in an interconnected and coordinated manner such that the firm proactively manages the quality of engagements performed by the firm. (Ref: par. A4)
9. The risk-based approach is embedded in the requirements of this proposed SQMS through the following:
  - a. *Establishing quality objectives.* The quality objectives established by the firm consist of objectives in relation to the components of the system of quality management that are to be achieved by the firm. The firm is required to establish the quality objectives specified by this proposed SQMS and any additional quality objectives considered necessary by the firm to achieve the objectives of the system of quality management.
  - b. *Identifying and assessing risks to the achievement of the quality objectives* (referred to in this standard as *quality risks*). The firm is required to identify and assess quality risks to provide a basis for the design and implementation of responses.
  - c. *Designing and implementing responses to address the quality risks.* The nature, timing, and extent of the firm’s responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks.
10. This proposed SQMS requires that, at least annually, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluate the system of quality management and concludes whether the system of

**Commented [AG3]:** To clarify that it may be one individual or more than one individuals; see rows 9- 10 of agenda item 4B

**Commented [LS4]:** See row 12 of agenda item 4B

quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph 15*a–b*, are being achieved. (Ref: par. A5)

***Scalability***

11. In applying a risk-based approach, the firm is required to take into account

- a.* the nature and circumstances of the firm, and
- b.* the nature and circumstances of the engagements performed by the firm.

Accordingly, the design of the firm’s system of quality management, in particular, the complexity and formality of the system, will vary. For example, a firm that performs different types of engagements for a wide variety of entities, such as audits of specialized industries or group audits for multinational entities, will likely need to have a more complex and formalized system of quality management and supporting documentation than a firm that performs only reviews of financial statements or compilation engagements.

***Networks and Service Providers***

12. This proposed SQMS addresses the firm’s responsibilities when the firm

- a.* belongs to a network, and the firm complies with network requirements or uses network services in the system of quality management or in performing engagements, or
- b.* uses resources from a service provider in the system of quality management or in performing engagements.

Even when the firm complies with network requirements or uses network services or resources from a service provider, the firm is responsible for its system of quality management.

***Authority of This Proposed SQMS***

13. Paragraph 15 contains the objective of the firm in following this proposed SQMS. This proposed SQMS contains the following: (Ref: par. A6)

- a.* Requirements designed to enable the firm to meet the objective in paragraph 15 (Ref: par. A7)
- b.* Related guidance in the form of application and other explanatory material (Ref: par. A8)
- c.* Introductory material that provides context relevant to a proper understanding of this proposed SQMS
- d.* Definitions (Ref: par. A9)

## Effective Date

14. Systems of quality management in compliance with this proposed SQMS are required to be designed and implemented by [December 15, 2023],\* and the evaluation of the system of quality management required by paragraphs 54–55 is required to be performed within one year following [December 15, 2023].

## Objective

15. The objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that
- the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and
  - engagement reports issued by the firm are appropriate in the circumstances.
16. The public interest is served by the consistent performance of quality engagements. The design, implementation, and operation of the system of quality management enables the consistent performance of quality engagements by providing the firm with reasonable assurance that the objectives of the system of quality management, stated in paragraph 15a–b, are achieved. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, ~~exercising~~ maintaining professional skepticism.

## Definitions

17. For purposes of the SQMSs, the following terms have the meanings attributed as follows:

**Accounting and auditing practice.** A practice that performs engagements covered by this section, which are audit, attestation, review, compilation, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee under the “General Standards Rule” (ET sec. 1.300.001)<sup>†</sup> or the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA ~~cCode of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.~~ (Ref: par. A9A)

**Deficiency in the firm’s system of quality management (referred to as *deficiency* in this proposed SQMS).** This exists when (Ref: par. A10 and A169–A170)

**Commented [AG5]:** To be consistent with ASB style; see rows 74 and 79, item 4D

**Commented [AG6]:** The reference to “Compliance with Standards Rule” was suggested for deletion (see row 18 of agenda item 4B), but TF determined not to delete because including this rule scopes in engagements in accordance with PCAOB or other standard setters.

**Commented [AG7]:** As defined in par. 4

**Commented [AG8]:** Moved to application guidance and expanded. See row 18 of agenda item 4B

\* This date is provisional but will not be earlier than December 15, 2023.

<sup>†</sup> All ET sections can be found in AICPA *Professional Standards*.

- a quality objective required to achieve the objective of the system of quality management is not established;
- a quality risk, or combination of quality risks, is not identified or properly assessed; (Ref: par. A11)
- a response, or combination of responses, does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the responses are not properly designed, implemented, or operating effectively; or
- an-other aspect of the system of quality management is absent, or not properly designed, implemented, or operating effectively, such that a requirement of this proposed SQMS has not been addressed. (Ref: par. A12–A13)

**Commented [LS9]:** Corrected typo  
See row 15 of agenda item 4B

**Engagement documentation.** The record of work performed, results obtained, and conclusions the practitioner reached (terms such as *working papers* or *work papers* are sometimes used).

**Engagement partner.** The partner or other individual, appointed by the firm, who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal, or regulatory body.

**Engagement quality review.** An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon performed by the engagement quality reviewer and completed on or before the date of the engagement report.

**Engagement quality reviewer.** A partner, other individual in the firm, or an external individual, appointed by the firm to perform the engagement quality review.

**Engagement team.** All partners and staff performing the engagement, and any other individuals who perform procedures on the engagement, excluding an external specialist<sup>1</sup> and internal auditors who provide direct assistance on an engagement. (Ref: par. A14)

**External inspections.** Inspections or investigations, undertaken by an external oversight authority, related to the firm's system of quality management or engagements performed by the firm. (Ref: par. A15)

**Findings (in relation to a system of quality management).** Information about the design, implementation, and operation of the system of quality management that has been accumulated from the performance of monitoring activities, external inspections, and other relevant sources, which indicates that one or more deficiencies may exist. (Ref: par. A16–A18)

<sup>1</sup> Paragraph .06 of AU-C section 620, *Using the Work of an Auditor's Specialist*, defines the term *auditor's specialist*.

**Firm.** A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in public practice. (Ref: par. A19)

**Inspection.** Inspection is an evaluation of the adequacy of the firm’s quality management policies and procedures, its personnel’s understanding of those policies and procedures, and the extent of the firm’s compliance with them.

**Commented [AG10]:** See row 14 of agenda item 4B. Definition is from extant but with the word “retrospective” removed to avoid confusion about in-process inspections.

**Network.** An association of entities that includes one or more firms, as defined in “Definitions” in the AICPA ~~c~~Code of Professional Conduct (ET section 0.400). (Ref: par. A20)

**Commented [AG11]:** To be more consistent with ET section 0.400.33 wording. See row 18 of agenda item 4B

**Network firm.** A firm or other entity that belongs to a network, as defined in “Definitions” in the AICPA Code of Professional Conduct (ET section 0.400). References to a *network firm* are to be read hereafter as “another firm or entity that belongs to the same network as the firm.”

**Partner.** Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

**Personnel.** Partners and staff in the firm. (Ref: par. A21–A22)

**Professional judgment.** The application of relevant training, knowledge, and experience, within the context of professional standards, in making informed decisions about the courses of action that are appropriate in the design, implementation, and operation of the firm’s system of quality management.

**Professional standards.** Standards promulgated by the ASB or the AICPA Accounting and Review Services Committee under the “General Standards Rule” (ET sec. 1.300.001) or the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA ~~c~~Code of Professional Conduct, or other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

**Quality objectives.** The desired outcomes in relation to the components of the system of quality management to be achieved by the firm.

**Quality risk.** A risk that has a reasonable possibility of

- occurring, and
- individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

**Reasonable assurance.** In the context of the SQMSs, a high, but not absolute, level of assurance.

**Relevant ethical requirements.** Principles of professional ethics and ethical requirements to which the firm, engagement team, engagement quality reviewer, and other firm personnel are subject when undertaking engagements in the firm’s accounting and auditing practice, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive. (Ref: par. A23–A24 and A64)

**Response (in relation to a system of quality management).** Policies or procedures designed and implemented by the firm to address one or more quality risks: (Ref: par. A25–A27 and A52)

- *Policies* are statements of what should, or should not, be done to address quality risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- *Procedures* are actions to implement policies.

**Service provider (in the context of this proposed SQMS).** An individual or organization external to the firm that provides a resource that is used in the system of quality management or in performing engagements. Service providers exclude the firm’s network, other network firms, or other structures or organizations in the network. (Ref: par. A28 and A110)

**Staff.** Professionals, other than partners, including any ~~experts~~specialists the firm employs.

**System of quality management.** A system designed, implemented, and operated by a firm to provide the firm with reasonable assurance that

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
- b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.

## Requirements

### Applying and Complying With Relevant Requirements

18. The firm ~~shall~~should comply with each requirement of this proposed SQMS unless the requirement is not relevant to the firm because of the nature and circumstances of the firm or its engagements. (Ref: par. A29)
19. The individual or individuals assigned ultimate responsibility and accountability for the firm’s system of quality management, and the individual or individuals assigned operational responsibility for the firm’s system of quality management, should have an understanding of this proposed SQMS, including the application and other explanatory material, to understand the objective of this proposed SQMS and to apply its requirements properly.

### **System of Quality Management**

20. The firm should design, implement, and operate a system of quality management. In doing so, the firm should exercise professional judgment, taking into account the nature and circumstances of the firm and its engagements. The governance and leadership component of the system of quality management establishes the environment that supports the design, implementation, and operation of the system of quality management (Ref: par. A30–A31)

### **Responsibilities**

21. The firm should assign (Ref: par. A32–A36)
- a. ultimate responsibility and accountability for the system of quality management to the firm’s CEO or the firm’s managing partner (or equivalent) or, if appropriate, the firm’s managing board of partners (or equivalent);
  - b. operational responsibility for the system of quality management; and
  - c. operational responsibility for specific aspects of the system of quality management, including
    - i. compliance with independence requirements, and (Ref: par. A37)
    - ii. the monitoring and remediation process.
22. In assigning the roles in paragraph 21, the firm should determine that the individual or individuals (Ref: par. A38)
- a. have the appropriate experience, knowledge, influence, and authority within the firm and sufficient time to fulfill their assigned responsibility, and (Ref: par. A39)
  - b. understand their assigned roles and that they are accountable for fulfilling them.
23. The firm should determine that the individual or individuals assigned operational responsibility for the system of quality management, compliance with independence requirements, and the monitoring and remediation process, have a direct line of communication to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management.

### **The Firm’s Risk Assessment Process**

24. The firm should design and implement a risk assessment process to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks. (Ref: par. A40–A42)
25. The firm should establish the quality objectives specified by this proposed SQMS and any additional quality objectives considered necessary by the firm to achieve the objectives of the system of quality management. (Ref: par. A43–A45)
26. The firm should identify and assess quality risks to provide a basis for the design and implementation of responses. In doing so, the firm should do the following:

- a. Obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, including the following: (Ref: par. A46–A48)
    - i. With respect to the nature and circumstances of the firm, those relating to
      - (1) the complexity and operating characteristics of the firm;
      - (2) the strategic and operational decisions and actions, business processes, and business model of the firm;
      - (3) the characteristics and management style of leadership;
      - (4) the resources of the firm, including the resources provided by service providers;
      - (5) law, regulation, professional standards, and the environment in which the firm operates; and
      - (6) in the case of a firm that belongs to a network, the nature and extent of the network requirements and network services, if any
    - ii. With respect to the nature and circumstances of the engagements performed by the firm, those relating to
      - (1) the types of engagements performed by the firm and the reports to be issued, and
      - (2) the types of entities for which such engagements are undertaken
  - b. Take into account how, and the degree to which, the conditions, events, circumstances, actions, or inactions in paragraph 26a may adversely affect the achievement of the quality objectives. (Ref: par. A49–A50)
27. The firm should design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks. The firm’s responses should also include the responses specified in paragraph 35. However, the specified responses specified in paragraph 35 alone are not sufficient to achieve the objectives of the system of quality management. (Ref: par. A51–A53)
28. The firm should establish policies or procedures that are designed to identify information that indicates additional quality objectives, or additional or modified quality risks or responses, are needed due to changes in the nature and circumstances of the firm or its engagements. If such information is identified, the firm should consider the information and, when appropriate (Ref: par. A54–A55)
- a. establish additional quality objectives or modify additional quality objectives previously established by the firm; (Ref: par. A56)
  - b. identify and assess additional quality risks, modify the quality risks, or reassess the quality risks; or
  - c. design and implement additional responses or modify the responses.

**Commented [AG12]:** Moved from par. A124 to be essential guidance. See row 135 in agenda item 4B

### **Governance and Leadership**

29. The firm should establish the following quality objectives that address the firm’s governance and leadership, which establishes the environment that supports the system of quality management:
- a. The firm demonstrates a commitment to quality through a culture that exists throughout the firm, which recognizes and reinforces the following: (Ref: par. A57–A58)
    - i. The firm’s role in serving the public interest by consistently performing quality engagements
    - ii. The importance of professional ethics, values, and attitudes
    - iii. The responsibility of all personnel for quality relating to the performance of engagements or activities within the system of quality management and their expected behavior
    - iv. The importance of quality in the firm’s strategic decisions and actions, including the firm’s financial and operational priorities
  - b. Leadership is responsible and accountable for quality. (Ref: par. A59)
  - c. Leadership demonstrates a commitment to quality through its actions and behaviors. (Ref: par. A60)
  - d. The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm’s system of quality management. (Ref: par. A32–A35 and A61)
  - e. Resource needs, including financial resources, are planned for, and resources are obtained, allocated, or assigned in a manner that is consistent with the firm’s commitment to quality. (Ref: par. A62–A63)

### **Relevant Ethical Requirements**

30. The firm should establish the following quality objectives that address the fulfillment of responsibilities in accordance with relevant ethical requirements, including those related to independence: (Ref: par. A64–A66 and A68)
- a. The firm and its personnel
    - i. understand the relevant ethical requirements to which the firm and the firm’s engagements are subject, and (Ref: par. A23)
    - ii. fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm’s engagements are subject.
  - b. Others, including the network, network firms, individuals in the network or network firms, or service providers, who are subject to the relevant ethical requirements to which the firm and the firm’s engagements are subject
    - i. understand the relevant ethical requirements that apply to them, and (Ref: par. A23, A67)

- ii. fulfill their responsibilities in relation to the relevant ethical requirements that apply to them. (Ref: par. A68)

### Acceptance and Continuance of Client Relationships and Specific Engagements

31. The firm should establish the following quality objectives that address the acceptance and continuance of client relationships and specific engagements:
- a. Judgments by the firm about whether to accept or continue a client relationship or specific engagement are appropriate based on the following:
    - i. Information obtained about the nature and circumstances of the engagement and the integrity and ethical values of the client (including management, and, when appropriate, those charged with governance) that is sufficient to support such judgments (Ref: par. A69–A74)
    - ii. The firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements (Ref: par. A75–A76)
  - b. The financial and operational priorities of the firm do not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement. (Ref: par. A77–A78)

### Engagement Performance

32. The firm should establish the following quality objectives that address the performance of quality engagements:
- a. Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement. (Ref: par. A79)
  - b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements ~~and t-~~ The resources assigned or made available to the engagement teams; the work performed by less experienced engagement team members is directed, supervised, and reviewed by ~~more suitably~~ experienced engagement team members. (Ref: par. A80–A81)
  - c. Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, ~~maintain~~ professional skepticism. (Ref: par. A82)
  - d. Consultation on difficult or contentious matters is undertaken, and the conclusions agreed to are implemented. (Ref: par. A83–A85)
  - e. Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm’s system of quality management, are brought to the attention of the firm and resolved. (Ref: par. A86)

Commented [AG13]: To correct; see rows 70-73 in 4B.

Commented [AG14]: To be consistent with extant

- f. Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, and professional standards. (Ref: par. A87–A89)

### Resources

- 33. The firm should establish the following quality objectives that address appropriately obtaining, developing, using, maintaining, allocating, and assigning resources in a timely manner to enable the design, implementation, and operation of the system of quality management: (Ref: par. A90–A91)

#### *Human Resources*

- a. Personnel are hired, developed, and retained and have the competence and capabilities to (Ref: par. A92–A94)
  - i. consistently perform quality engagements, including having knowledge or experience relevant to the engagements the firm performs, or
  - ii. perform activities or carry out responsibilities in relation to the operation of the firm’s system of quality management.
- b. Personnel demonstrate a commitment to quality through their actions and behaviors, develop and maintain the appropriate competence to perform their roles, and are held accountable or recognized through timely evaluations, compensation, promotion, and other incentives. (Ref: par. A95–A97)
- c. Individuals are obtained from external sources (that is, the network, another network firm, or a service provider) when the firm does not have sufficient or appropriate personnel to enable the operation of firm’s system of quality management or performance of engagements. (Ref: par. A98)
- d. Engagement team members are assigned to each engagement, including an engagement partner, who have appropriate competence and capabilities, including being given sufficient time, to consistently perform quality engagements. (Ref: par. A92–A93, A99–A101)
- e. Individuals who have appropriate competence and capabilities, including sufficient time, to perform such activities are assigned to perform activities within the system of quality management.

#### *Technological Resources*

- f. Appropriate technological resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm’s system of quality management and the performance of engagements. (Ref: par. A102–A106 and A109)

#### *Intellectual Resources*

- g. Appropriate intellectual resources are obtained or developed, implemented, maintained, and used to enable the operation of the firm’s system of quality management and the consistent performance of quality engagements, and such intellectual resources are

consistent with professional standards and applicable legal and regulatory requirements, where applicable. (Ref: par. A107–A109)

*Service Providers*

- h.* Human, technological, or intellectual resources from service providers are appropriate for use in the firm’s system of quality management and in performing engagements, taking into account the quality objectives in paragraph 33*d–g*. (Ref: par. A110–A115)

**Information and Communication**

- 34.** The firm should establish the following quality objectives that address obtaining, generating, or using information regarding the system of quality management and communicating information within the firm and to external parties on a timely basis to enable the design, implementation, and operation of the system of quality management: (Ref: par. A116)
  - a.* The information system identifies, captures, processes, and maintains relevant and reliable information that supports the system of quality management, whether from internal or external sources. (Ref: par. A117–A119)
  - b.* The culture of the firm recognizes and reinforces the responsibility of personnel to exchange information with the firm and with one another. (Ref: par. A120)
  - c.* Relevant and reliable information is exchanged throughout the firm and with engagement teams, including the following: (Ref: par. A120)
    - i.* Information is communicated to personnel and engagement teams, and the nature, timing, and extent of the information is sufficient to enable them to understand and carry out their responsibilities relating to performing activities within the system of quality management or engagements.
    - ii.* Personnel and engagement teams communicate information to the firm when performing activities within the system of quality management or engagements.
  - d.* Relevant and reliable information is communicated to external parties, including the following:
    - i.* Information is communicated by the firm to or within the firm’s network or to service providers, if any, enabling the network or service providers to fulfill their responsibilities relating to the network requirements or network services or resources provided by them. (Ref: par. A121 )
    - ii.* Information is communicated externally when required by law, regulation, or professional standards or to support external parties’ understanding of the system of quality management. (Ref: par. A122–A123)

**Specified Responses**

- 35.** In designing and implementing responses in accordance with paragraph 27, the firm should include the following responses: (Ref: par. A124)
  - a.* The firm establishes policies or procedures for
    - i.* identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements. (Ref: par. A125)

- ii. identifying, communicating, evaluating, and reporting of any breaches of the relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner. (Ref: par. A126–A127)
- b. The firm obtains, at least annually, a documented confirmation of compliance with independence requirements from all personnel required by relevant ethical requirements to be independent.
- c. The firm establishes policies or procedures for receiving, investigating, and resolving complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm’s policies or procedures established in accordance with this proposed SQMS. (Ref: par. A128–A129)
- d. The firm establishes policies or procedures that address the following circumstances:
  - i. The firm becomes aware of information subsequent to accepting or continuing a client relationship or specific engagement that would have caused it to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement. (Ref: par. A130–A131)
  - ii. The firm is obligated by law or regulation to accept a client relationship or specific engagement. (Ref: par. A132–A133)
- e. The firm establishes policies or procedures that (Ref: par. A134–A137)
  - i. address when it is appropriate to communicate with external parties about the firm’s system of quality management, and (Ref: par. A138–A140)
  - ii. address the information to be provided when communicating externally about the firm’s system of quality management, including the nature, timing, and extent and appropriate form of communication. (Ref: par. A141–A142)
- f. The firm establishes policies or procedures that address engagement quality reviews in accordance with proposed SQMS *Engagement Quality Reviews* and requires an engagement quality review for the following:
  - i. Audits or other engagements for which an engagement quality review is required by law or regulation (Ref: par. A143)
  - ii. Audits or other engagements for which the firm determines that an engagement quality review is an appropriate response to address one or more quality risks (Ref: par. A144–A147)

**Monitoring and Remediation Process**

36. The firm should establish a monitoring and remediation process to (Ref: par. A148)
- a. provide relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
  - b. take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.

***Designing and Performing Monitoring Activities***

37. The firm should design and perform monitoring activities to provide a basis for the identification of deficiencies.
38. In determining the nature, timing, and extent of the monitoring activities, the firm should take the following into account: (Ref: par. A149–A152)
- a. The reasons for the assessments given to the quality risks
  - b. The design of the responses
  - c. The design of the firm’s risk assessment process and monitoring and remediation process (Ref: par. A153–A155)
  - d. Changes in the system of quality management (Ref: par. A156)
  - e. The results of previous monitoring activities, whether previous monitoring activities continue to be relevant in evaluating the firm’s system of quality management and whether remedial actions to address previously identified deficiencies were effective (Ref: par. A157–A158)
  - f. Other relevant information, including complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm’s policies or procedures established in accordance with this proposed SQMS, information from external inspections, and information from service providers (Ref: par. A159–A161)
39. The firm should include the inspection of completed engagements in its monitoring activities and should determine which engagements and engagement partners to select. In doing so, the firm should (Ref: par. A150 and A162–A166)
- a. take into account the matters in paragraph 38;
  - b. consider the nature, timing, and extent of other monitoring activities undertaken by the firm and the engagements and engagement partners subject to such monitoring activities; (Ref: par. A167) and
  - c. select at least one completed engagement for each engagement partner on a cyclical basis determined by the firm.
40. The firm should establish policies or procedures that
- a. require the individuals performing the monitoring activities to have the competence and capabilities, including sufficient time, to perform the monitoring activities effectively.
  - b. address the objectivity of the individuals performing the monitoring activities. ~~Such policies or procedures should prohibit~~ based on the premise that objectivity is enhanced when the engagement team members or the engagement quality reviewer of an engagement ~~are not involved in~~ ~~from~~ performing any inspection of that engagement. (Ref: par. A168–A169)

**Commented [LS15]:** Updated based on feedback received and ASB direction to not include an explicit prohibition on self-inspection

***Evaluating Findings and Identifying Deficiencies***

41. The firm should evaluate findings to determine whether deficiencies exist, including in the monitoring and remediation process. (Ref: par. A170–A174)

***Evaluating Identified Deficiencies***

42. The firm should evaluate the severity and pervasiveness of identified deficiencies by (Ref: par. A173, A175–A176)
- a. investigating the root causes of the identified deficiencies. In determining the nature, timing, and extent of the procedures to investigate the root causes, the firm should take into account the nature of the identified deficiencies and their possible severity. (Ref: par. A177–A181)
  - b. evaluating the effect of the identified deficiencies, individually and in aggregate, on the system of quality management.

***Responding to Identified Deficiencies***

43. The firm should design and implement remedial actions to address identified deficiencies that are responsive to the results of the root cause analysis. (Ref: par. A182–A184)
44. The individual or individuals assigned operational responsibility for the monitoring and remediation process should evaluate whether the remedial actions
- a. are appropriately designed to address the identified deficiencies and their related root causes and determine that they have been implemented.
  - b. implemented to address previously identified deficiencies are effective.
45. If the evaluation indicates that the remedial actions are not appropriately designed and implemented or are not effective, the individual or individuals assigned operational responsibility for the monitoring and remediation process should take appropriate action to determine that the remedial actions are appropriately modified such that they are effective.

***Findings About a Particular Engagement***

46. The firm should respond to circumstances when findings indicate that there is an engagement for which required procedures were omitted during the performance of the engagement, or the report issued may be inappropriate. The firm's response should include the following: (Ref: par. A185)
- a. Taking appropriate action to comply with relevant professional standards and applicable legal and regulatory requirements
  - b. When the report is considered to be inappropriate, considering the implications and taking appropriate action, including considering whether to obtain legal advice

***Ongoing Communication Related to Monitoring and Remediation***

47. The individual or individuals assigned operational responsibility for the monitoring and remediation process should communicate the following on a timely basis to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management and the individual or individuals assigned operational responsibility for the system of quality management: (Ref: par. A186)

- a.* A description of the monitoring activities performed
  - b.* The identified deficiencies, including the severity and pervasiveness of such deficiencies
  - c.* The remedial actions to address the identified deficiencies
48. The firm should communicate the matters described in paragraph 47 to engagement teams and other individuals assigned activities within the system of quality management to enable them to take prompt and appropriate action in accordance with their responsibilities.

**Network Requirements or Network Services**

49. When the firm belongs to a network, the firm should understand the following, when applicable: (Ref: par. A20 and A187–A189)
- a.* The requirements established by the network regarding the firm’s system of quality management, including requirements for the firm to implement or use resources or services designed or otherwise provided by or through the network (that is, network requirements)
  - b.* Any services or resources provided by the network that the firm chooses to implement or use in the design, implementation, or operation of the firm’s system of quality management (that is, network services)
  - c.* The firm’s responsibilities for any actions that are necessary to implement the network requirements or use network services (Ref: par. A190)

The firm remains responsible for its system of quality management, including professional judgments made in the design, implementation, and operation of the system of quality management. The firm should not allow compliance with the network requirements or use of network services to contravene the requirements of this proposed SQMS. (Ref: par. A20 and A191)

50. Based on the understanding obtained in accordance with paragraph 49, the firm should
- a.* determine how the network requirements or network services are relevant to, and are taken into account in, the firm’s system of quality management, including how they are to be implemented. (Ref: par. A192)
  - b.* evaluate whether and, if so, how the network requirements or network services need to be adapted or supplemented by the firm to be appropriate for use in its system of quality management. (Ref: par. A193–A195)

***Monitoring Activities Undertaken by the Network on the Firm’s System of Quality Management***

51. In circumstances when the network performs monitoring activities relating to the firm’s system of quality management, the firm should
- a.* determine the effect of the monitoring activities performed by the network on the nature, timing, and extent of the firm’s monitoring activities performed in accordance with paragraphs 37–39;
  - b.* determine the firm’s responsibilities in relation to the monitoring activities, including

any related actions by the firm; and

- c. as part of evaluating findings and identifying deficiencies in paragraph 41, obtain the results of the monitoring activities from the network in a timely manner. (Ref: par. A196)

***Monitoring Activities Undertaken by the Network Across the Network Firms***

52. The firm should

- a. understand the overall scope of the monitoring activities undertaken by the network across the network firms, including monitoring activities to determine that network requirements have been appropriately implemented across the network firms, and how the network will communicate the results of its monitoring activities to the firm.
- b. at least annually, obtain information from the network about the overall results of the network’s monitoring activities across the network firms, if applicable, and (Ref: par. A197–A199)
  - i. communicate the information to engagement teams and other individuals assigned activities within the system of quality management, as appropriate, to enable them to take prompt and appropriate action in accordance with their responsibilities, and
  - ii. consider the effect of the information on the firm’s system of quality management.

***Deficiencies in Network Requirements or Network Services Identified by the Firm***

53. If the firm identifies a deficiency in the network requirements or network services, the firm should (Ref: par. A200)

- a. communicate to the network relevant information about the identified deficiency, and
- b. in accordance with paragraph 43, design and implement remedial actions to address the effect of the identified deficiency in the network requirements or network services. (Ref: par. A201)

**Evaluating the System of Quality Management**

54. The individual or individuals assigned ultimate responsibility and accountability for the system of quality management should evaluate, on behalf of the firm, the system of quality management. The evaluation should be undertaken as of a point in time and performed at least annually. (Ref: par. A202–A205)

55. Based on the evaluation, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management should conclude, on behalf of the firm, one of the following: (Ref: par. A206 and A213)

- a. The system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. A207)
- b. Except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality

management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. A208)

- c. The system of quality management does not provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved. (Ref: par. A208–A212)

56. If the individual or individuals assigned ultimate responsibility and accountability for the system of quality management reaches the conclusion described in paragraph 55b or 55c, the firm should do the following: (Ref: par. A214)

- a. Take prompt and appropriate action
- b. Communicate to
  - i. engagement teams and other individuals assigned activities within the system of quality management to the extent that it is relevant to their responsibilities, and (Ref: par. A215)
  - ii. external parties in accordance with the firm’s policies or procedures required by paragraph 35e. (Ref: par. A216)

57. The firm should undertake periodic performance evaluations of the individual or individuals assigned ultimate responsibility and accountability for the system of quality management and the individual or individuals assigned operational responsibility for the system of quality management. In doing so, the firm should take into account the evaluation of the system of quality management. (Ref: par. A217–A219)

#### Documentation

58. The firm should prepare documentation of its system of quality management that is sufficient to (Ref: par. A220–A222)

- a. support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the system of quality management and performing engagements.
- b. support the consistent implementation and operation of the responses.
- c. provide evidence of the design, implementation, and operation of the responses to support the evaluation of the system of quality management by the individual or individuals assigned ultimate responsibility and accountability for the system of quality management.

59. In preparing documentation, the firm should include the following:

- a. Identification of the individual or individuals assigned ultimate responsibility and accountability for the system of quality management and operational responsibility for the system of quality management
- b. The firm’s quality objectives and quality risks (Ref: par. A223)
- c. A description of the responses and how the firm’s responses address the quality risks

- d. Regarding the monitoring and remediation process:
  - i. Evidence of the monitoring activities performed
  - ii. The evaluation of findings, and identified deficiencies and their related root causes
  - iii. Remedial actions to address identified deficiencies and the evaluation of the design and implementation of such remedial actions
  - iv. Communications about monitoring and remediation
- e. The ~~basis for the~~ conclusion reached pursuant to paragraph 55 ~~and the basis therefor~~

**Commented [AG16]:** To require that the conclusion be documented. See row 119, 4B.

- 60. The firm should document the matters in paragraph 59 as they relate to network requirements or network services and the evaluation of the network requirements or network services in accordance with paragraph 50b. (Ref: par. A224)
- 61. The firm should establish a period of time for the retention of documentation for the system of quality management that is sufficient to enable the firm ~~and its peer reviewer~~ to monitor the design, implementation, and operation of the firm’s system of quality management or for a longer period if required by law or regulation.

**Commented [AG17]:** See row 123, 4B. To align with extant.

## Application and Other Explanatory Material

### Scope of This Proposed SQMS (Ref: par. 3–4)

~~A1. Other professional standards, including AT-C section 105, *Concepts Common to All Attestation Engagements*<sup>‡</sup>, and AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*,<sup>‡</sup> also establish requirements for the engagement partner for the management of quality at the engagement level.~~

**Commented [AG18]:** Moved to paragraph 3 to give equal prominence to other engagements and not over-emphasize audits. See agenda item 4B row 6

### *A1. [placeholder to retain Exposure Draft numbering]*

A2. The AICPA code establishes the fundamental principles of professional ethics, which include the obligation to act in a way that serves the public interest.<sup>2</sup> As indicated in paragraph 16, in the context of engagement performance as described in this proposed SQMS, the consistent performance of quality engagements forms part of the obligation to act in the public interest.

### The Firm’s System of Quality Management (Ref: par. 7–10)

A3. The firm may use different terminology or frameworks to describe the components of its system of quality management.

A4. Examples of the interconnected nature of the components include the following:

- The firm’s risk assessment process sets out the process the firm is required to follow in implementing a risk-based approach across the system of quality management.

<sup>‡</sup>All AT-C sections can be found in *AICPA Professional Standards*.

<sup>‡</sup>All AR-C sections can be found in *AICPA Professional Standards*.

<sup>2</sup> ET section 0.300.030.01.

- The governance and leadership component establishes the environment that supports the system of quality management.
- The resources and information and communication components enable the design, implementation, and operation of the system of quality management.
- The monitoring and remediation process is designed to monitor the entire system of quality management. The results of the monitoring and remediation process provide information that is relevant to the firm’s risk assessment process.
- There may be relationships between specific matters, for example, certain aspects of relevant ethical requirements are relevant to accepting and continuing client relationships and specific engagements.

**A5.** Reasonable assurance is obtained when the system of quality management reduces to an acceptably low level the risk that the objectives stated in paragraph 15a–b are not achieved. Reasonable assurance is not an absolute level of assurance because there are inherent limitations of a system of quality management. Such limitations include that human judgment in decision making can be faulty and that breakdowns in a firm’s system of quality management may occur, for example, due to human error or behavior or failures in IT applications.

**Authority of This Proposed SQMS** (Ref: par. 13)

**A6.** The objective of this proposed SQMS provides the context in which the requirements of this proposed SQMS are set, establishes the desired outcome of this proposed SQMS, and is intended to assist the firm in understanding what needs to be accomplished and, when necessary, the appropriate means of doing so.

**A7.** The requirements of this proposed SQMS are expressed using the word *should*.

**A8.** When necessary, the application and other explanatory material provides further explanation of the requirements and guidance for carrying them out. In particular, it may

- explain more precisely what a requirement means or is intended to cover, and
- include examples that illustrate how the requirements might be applied.

Although such guidance does not, in itself, impose a requirement, it is relevant to the proper application of the requirements. The application and other explanatory material may also provide background information on matters addressed in this proposed SQMS. These additional considerations assist in the application of the requirements in this proposed SQMS. They do not, however, limit or reduce the responsibility of the firm to apply and comply with the requirements in this proposed SQMS.

**A9.** This proposed SQMS includes, under the heading, “Definitions,” a description of the meanings attributed to certain terms for purposes of this proposed SQMS. These definitions are provided to assist in the consistent application and interpretation of this proposed SQMS and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise.

## Definitions

### Accounting and Auditing Practice (Ref: par. 17)

A9A. Standards promulgated by the ASB and AICPA Accounting and Review Services Committee that apply to engagements covered by this standard comprise the following:

- Statements on Auditing Standards (SASs)
- Statements on Standards for Attestation Engagements (SSAEs)
- Statements on Standards for Accounting and Review Services (SSARSs)

Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an *accounting and auditing practice*.

**Commented [AG19]:** Added to clarify. See row 18 of 4B.

### Deficiency (Ref: par. 17~~b~~)

**A10.** The firm identifies deficiencies by evaluating findings. A deficiency may arise from a finding or a combination of findings.

**A11.** When a deficiency is identified as a result of a quality risk, or combination of quality risks, not being identified or properly assessed, the responses to address such quality risks may also be absent or not appropriately designed or implemented.

**A12.** The other aspects of the system of quality management consist of the requirements in this proposed SQMS addressing the following:

- Assigning responsibilities (paragraphs 21–22)
- The firm’s risk assessment process
- The monitoring and remediation process
- The evaluation of the system of quality management

**A13.** Examples of deficiencies related to other aspects of the system of quality management include the following:

- The firm’s risk assessment process fails to identify information that indicates changes in the nature and circumstances of the firm and its engagements and the need to establish additional quality objectives or modify the quality risks or responses.
- The firm’s monitoring and remediation process is not designed or implemented in a manner that
  - provides relevant, reliable, and timely information about the design, implementation, and operation of the system of quality management.
  - enables the firm to take appropriate actions to respond to identified deficiencies such that deficiencies are remediated on a timely basis.
- The individual or individuals assigned ultimate responsibility and accountability for the system of quality management do not undertake the annual evaluation of the system of quality management.

**Commented [AG20]:** Removed letter references throughout this section of application guidance because paragraph 17 does not use sub-lettering convention

**Engagement Team (Ref: par. 17~~g~~)**

**A14.** Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>3</sup> provides guidance in applying the definition of *engagement team* in the context of an audit of financial statements. AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*,<sup>4</sup> expands on how proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* is to be applied in relation to an audit of group financial statements. The quality risks and responses to those risks relevant to group audit engagements may be different for engagement team members who are firm personnel than for engagement team members who are external to the firm (for example, engagement team members who are from network firms or are service providers, such as component auditors from firms not within the firm’s network).

**External Inspections (Ref: par. 17~~h~~)**

**A15.** In some circumstances, an external oversight authority, such as the U.S. Department of Labor, may undertake other types of inspections, for example, reviews that focus on, for a selection of firms, particular aspects of audit engagements or firm-wide practices.

**Commented [AG21]:** See row 14 of item 4B. Added to provide example.

**Findings (Ref: par. 17~~i~~)**

**A16.** As part of accumulating findings from monitoring activities, external inspections, and other relevant sources, the firm may identify other observations about the firm’s system of quality management, such as positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management. Paragraph A168 explains how other observations may be used by the firm in the system of quality management.

**A17.** Paragraph A157 provides examples of information from other relevant sources.

**A18.** Monitoring activities include monitoring at the engagement level, such as inspection of engagements. Furthermore, external inspections and other relevant sources may include information that relates to specific engagements. As a result, information about the design, implementation, and operation of the system of quality management includes engagement-level findings that may be indicative of findings in relation to the system of quality management.

**Firm (Ref: par. 17~~j~~)**

**A19.** The definition of *firm* in relevant ethical requirements may differ from the definition set out in this proposed SQMS.

**Network (Ref: par. 17~~k~~ and 49)**

**A20.** Networks and the firms within the network may be structured in a variety of ways. For example, in the context of a firm’s system of quality management:

<sup>3</sup> Paragraphs A15–A21 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

<sup>4</sup> All AU-C sections can be found in *AICPA Professional Standards*.

- The network may establish requirements for the firm related to its system of quality management or provide services that are used by the firm in its system of quality management or in performing engagements.
- Other firms within the network may provide services (for example, resources) that are used by the firm in its system of quality management or in performing engagements.
- Other structures or organizations within the network may establish requirements for the firm related to its system of quality management or provide services.

For the purposes of this proposed SQMS, any network requirements or network services that are obtained from the network, another firm within the network, or another structure or organization in the network are considered “network requirements or network services.”

***Personnel (Ref: par. 17#)***

**A21.** In addition to personnel (that is, individuals in the firm), the firm may use individuals external to the firm in performing activities in the system of quality management or in performing engagements. For example, individuals external to the firm may include individuals from other network firms (for example, individuals in a service delivery center of a network firm) or individuals employed by a service provider (for example, a component auditor from another firm not within the firm’s network).

**A22.** Personnel also includes partners and staff in other structures of the firm, such as a service delivery center in the firm.

***Relevant Ethical Requirements (Ref: par. 17# and 30)***

**A23.** The relevant ethical requirements that are applicable in the context of a system of quality management may vary, depending on the nature and circumstances of the firm and its engagements. The AICPA code acknowledges that federal, state, or local statutes, rules, or regulations may be more restrictive than the AICPA code.

**A24.** Various provisions of the relevant ethical requirements may apply only to individuals in the context of the performance of engagements and not the firm itself. For example, the AICPA code prohibits individuals from knowingly misrepresenting facts or subordinating their judgment when performing professional services for a client or for an employer (ET sec. 1.100.001). Compliance with such relevant ethical requirements by individuals may need to be addressed by the firm’s system of quality management.

***Response (Ref: par. 17#)***

**A25.** Policies are implemented through the actions of personnel and other individuals whose actions are subject to the policies (including engagement teams) or through their restraint from taking actions that would conflict with the firm’s policies.

**A26.** Procedures may be mandated, through formal documentation or other communications, or may result from behaviors that are not mandated but, rather, are conditioned by the firm’s culture. Procedures may be enforced through the actions permitted by IT applications or other aspects of the firm’s IT environment.

**A27.** If the firm uses individuals external to the firm in the system of quality management or in performing engagements, different policies or procedures may need to be designed by the firm to

address the actions of the individuals. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>5</sup> provides guidance when different policies or procedures may need to be designed by the firm to address the actions of individuals external to the firm in the context of an audit of financial statements.

**Service Provider (Ref: par. 17\*)**

**A28.** Service providers include component auditors from other firms not within the firm’s network.

**Applying, and Complying With, Relevant Requirements (Ref: par. 18)**

**A29.** Examples of when a requirement of this proposed SQMS may not be relevant to the firm include the following:

- The firm is a sole practitioner. For example, the requirements addressing the organizational structure and assigning roles, responsibilities, and authority within the firm; direction, supervision, and review; and addressing differences of opinion may not be relevant.
- The firm only performs engagements that are preparation of financial statements engagements in accordance with AR-C section 70, *Preparation of Financial Statements*. For example, because the firm is not required to maintain independence for preparation of financial statements engagements, the requirement to obtain a documented confirmation of compliance with independence requirements from all personnel would not be relevant.

Commented [AG22]: See row 126, 4B

**System of Quality Management**

***Design, Implement, and Operate a System of Quality Management (Ref: par. 20)***

**A30.** Quality management is not a separate function of the firm; it is the integration of a culture that demonstrates a commitment to quality with the firm’s strategy, operational activities, and business processes. As a result, designing the system of quality management and the firm’s operational activities and business processes in an integrated manner may promote a harmonious approach to managing the firm and enhance the effectiveness of quality management.

**A31.** The quality of professional judgments exercised by the firm is likely to be enhanced when individuals making such judgments demonstrate an attitude that includes an inquiring mind, which involves

- considering the source, relevance, and sufficiency of information obtained about the system of quality management, including information related to the nature and circumstances of the firm and its engagements, and
- being open and alert to a need for further investigation or other action.

<sup>5</sup> Paragraphs A22–A24 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

**Responsibilities (Ref: par. 21–22 and 29d)**

**A32.** The governance and leadership component includes a quality objective that the firm has an organizational structure and assignment of roles, responsibilities, and authority that is appropriate to enable the design, implementation, and operation of the firm’s system of quality management.

**A33.** Notwithstanding the assignment of responsibilities related to the system of quality management in accordance with paragraph 21, the firm remains ultimately responsible for the system of quality management and holding individuals responsible and accountable for their assigned roles. For example, in accordance with paragraphs 54 and 55, although the firm assigns the evaluation of the system of quality management and conclusion thereon to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management, the firm is responsible for the evaluation and conclusion.

**A34.** ~~An individual~~ Individuals assigned responsibility for the matters in paragraph 21 ~~is~~ are typically a partner~~s~~ of the firm so that ~~the individual has~~ they have appropriate influence and authority within the firm, as required by paragraph 22. However, based on the legal structure of the firm, there may be circumstances when an individual may not be a partner of the firm, but the individual has the appropriate influence and authority within the firm to perform the assigned role because of formal arrangements made by the firm or the firm’s network.

**A35.** How the firm assigns roles, responsibilities, and authority within the firm may vary, and law or regulation may impose certain requirements for the firm that affect the leadership and management structure or their assigned responsibilities. An individual assigned responsibility for a matter in paragraph 21 may further assign roles, procedures, tasks, or actions to other individuals to assist the individual in fulfilling the responsibilities. However, an individual assigned responsibility for a matter in paragraph 22 remains responsible and accountable for the responsibilities assigned to the individual.

**A36.** An example of scalability to demonstrate how assigning roles and responsibilities may be undertaken in firms of different complexity is as follows:

- In a less complex firm, ultimate responsibility and accountability for the system of quality management may be assigned to a single managing partner with sole responsibility for the oversight of the firm. This individual may also assume responsibility for all aspects of the system of quality management, including operational responsibility for the system of quality management, compliance with independence requirements, and the monitoring and remediation process.
- In a more complex firm, the organizational structure of the firm may include the multiple levels of leadership, and the firm may have an independent governing body that has nonexecutive oversight of the firm, which may comprise external individuals. Furthermore, the firm may assign operational responsibility for specific aspects of the system of quality management beyond those specified in paragraph 21c, such as operational responsibility for compliance with ethical requirements or operational responsibility for managing a service line.

**A37.** Compliance with independence requirements is essential to the performance of engagements in a firm’s accounting and auditing practice and is an expectation of stakeholders relying on the firm’s reports. The individual or individuals assigned operational responsibility for

compliance with independence requirements are ordinarily responsible for the oversight of all matters related to independence so that a robust and consistent approach is designed and implemented by the firm to deal with independence requirements.

**A38.** Law, regulation, or professional standards may establish additional requirements for an individual assigned responsibility for a matter in paragraph 21, such as requirements for professional licensing, professional education, or continuing professional development.

**A39.** The appropriate experience and knowledge for the individual or individuals assigned operational responsibility for the system of quality management ordinarily includes an understanding of the firm's strategic decisions and actions and experience with the firm's business operations.

**The Firm's Risk Assessment Process** (Ref: par. 24)

**A40.** How the firm designs the firm's risk assessment process may be affected by the nature and circumstances of the firm, including how the firm is structured and organized.

Examples of scalability to demonstrate how the firm's risk assessment process may differ from that of other firms include the following:

- In a less complex firm, the individual or individuals assigned operational responsibility for the system of quality management may have a sufficient understanding of the firm and its engagements to undertake the risk assessment process. Furthermore, the documentation of the quality objectives, quality risks, and responses may be less extensive than for a more complex firm (for example, it may be documented in a single document).
- In a more complex firm, there may be a formal risk assessment process involving multiple individuals and numerous activities. The process may be centralized (for example, the quality objectives, quality risks, and responses are established centrally for all business units, functions, and service lines) or decentralized (for example, the quality objectives, quality risks, and responses are established at a business unit, function, or service line level, with the outputs combined at the firm level). The firm's network may also provide the firm with quality objectives, quality risks, and responses to be included in the firm's system of quality management.

**A41.** The process of establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses is iterative, and the requirements of this proposed SQMS are not intended to be addressed in a linear manner. Examples of the iterative and nonlinear nature of the firm's risk assessment process include the following:

- In identifying and assessing quality risks, the firm might determine that an additional quality objective needs to be established.
- When designing and implementing responses, the firm might determine that a quality risk was not identified and assessed.

**A42.** Information sources that enable the firm to establish quality objectives, identify and assess quality risks, and design and implement responses are part of the firm's information and communication component and include the following:

- The results of the firm’s monitoring and remediation process (see paragraphs 43 and A169).
- Information from the network or service providers, including
  - information about network requirements or network services (see paragraph 49), and
  - other information from the network, including information about the results of monitoring activities undertaken by the network across the network firms (see paragraphs 51–52).

Other information, ~~either whether~~ internal or external, may also be relevant to the firm’s risk assessment process, such as the following:

Commented [AG23]: More precise word. See row 143, 4B

- Information regarding complaints and allegations about failures to perform work in accordance with professional standards and applicable legal and regulatory requirements or noncompliance with the firm’s policies or procedures established in accordance with this proposed SQMS
- The results of external inspections
- Information from regulators about the entities for whom the firm performs engagements, which is made available to the firm, such as information from a securities regulator about an entity for whom the firm performs engagements (for example, irregularities in the entity’s financial statements or noncompliance with securities regulations)
- Changes in the system of quality management that affect other aspects of the system, for example, changes in the firm’s resources
- Other external sources, such as regulatory actions and litigation against the firm or other firms in the jurisdiction that may highlight areas for the firm to consider

#### ***Establish Quality Objectives (Ref: par. 25)***

A43. Law, regulation, or professional standards may establish requirements that give rise to additional quality objectives. For example, if a firm is required by law or regulation to appoint nonexecutive individuals to the firm’s governance structure, the firm may consider it necessary to establish additional quality objectives to address the requirements.

A44. ~~While the nature and circumstances of the firm and its engagements may bear specific to the firm, the quality objectives are sufficiently comprehensive~~ such that ~~it is unlikely that the firm may not would~~ find it necessary to establish additional quality objectives.

Commented [AG24]: See row 128, agenda item 4B. To clarify

A45. The firm may establish sub-objectives to enhance the firm’s identification and assessment of quality risks, and design and implementation of responses.

#### ***Identify and Assess Quality Risks (Ref: par. 26)***

A46. There may be other conditions, events, circumstances, actions, or inactions not described in paragraph 26a that may adversely affect the achievement of a quality objective.

A47. A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. Not all risks meet the

definition of a *quality risk*. Professional judgment assists the firm in determining whether a risk is a quality risk, which is based on the firm’s consideration of whether there is a reasonable possibility of the risk occurring, and individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives.

**A48.** Examples of the firm’s understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and the related quality risks are as follows:

<b>Examples of the firm’s understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives</b>	<b>Examples of quality risks that may arise</b>
<p>The strategic and operational decisions and actions, business processes, and business model of the firm: The firm’s overall financial goals are overly dependent on the extent of services provided by the firm not within the scope of this proposed SQMS.</p>	<p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <ul style="list-style-type: none"> <li>• Resources are allocated or assigned in a manner that prioritizes the services not within the scope of this proposed SQMS and may negatively affect the quality of engagements within the scope of this proposed SQMS.</li> <li>• Decisions about financial and operational priorities do not fully or adequately consider the importance of quality in performing engagements within the scope of this proposed SQMS.</li> </ul>
<p>The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.</p>	<p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <ul style="list-style-type: none"> <li>• Leadership’s responsibilities and accountability for quality are not clearly defined and assigned.</li> <li>• The actions and behaviors of</li> </ul>

	<p>leadership that do not promote quality are not questioned.</p>
<p>The complexity and operating characteristics of the firm: The firm has recently completed a merger with another firm.</p>	<p>In the context of resources, this may give rise to a number of quality risks, including the following:</p> <ul style="list-style-type: none"> <li>• Technological resources used by the two merged firms may be incompatible.</li> <li>• Engagement teams may use intellectual resources developed by a firm prior to the merger, which are no longer consistent with the new methodology being used by the new merged firm.</li> </ul>

**A49.** Given the evolving nature of the system of quality management, the responses designed and implemented by the firm may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks. For example, the firm may implement a resource (for example, a technological resource) to address a quality risk, and quality risks may arise from the use of such resource.

**A50.** The degree to which a risk, individually or in combination with other risks, may adversely affect the achievement of a quality objective may vary based on the conditions, events, circumstances, actions, or inactions giving rise to the risk, taking matters such as the following into account:

- How the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective
- How frequently the condition, event, circumstance, action, or inaction is expected to occur
- How long it would take after the condition, event, circumstance, action, or inaction occurred for it to have an effect, and whether in that time the firm would have an opportunity to respond to mitigate the effect of the condition, event, circumstance, action, or inaction.
- How long the condition, event, circumstance, action, or inaction would affect the achievement of the quality objective once it has occurred.

The assessment of quality risks need not comprise formal ratings or scores, although firms are not precluded from using them.

***Design and Implement Responses to Address the Quality Risks (Ref: par. 17# and 27)***

**A51.** The nature, timing, and extent of the responses are based on the reasons for the assessment given to the quality risks, ~~which is the firm's consideration of whether there is a reasonable possibility of the risk occurring, and individually, or in combination with other risks, adversely affecting, that is, the conclusions from the consideration of how, and the degree to which, conditions, events, circumstances, actions, or inaction may adversely affect~~ the achievement of one or more quality objectives.

Commented [AG25]: See row 129 of agenda item 4B.

**A52.** The responses designed and implemented by the firm may operate at the firm level or engagement level, or there may be a combination of responsibilities for actions to be taken at the firm and engagement level. An example of a response designed and implemented by the firm that operates at both the firm and engagement level is as follows:

The firm establishes policies or procedures for consultation, which include with whom consultation should be undertaken by engagement teams and the specific matters for which consultation is required. The firm appoints suitably qualified and experienced individuals to provide the consultations. The engagement team is responsible for identifying when matters for consultation occur and initiating consultation, and implementing the conclusions from consultation.

**A53.** The need for formally documented policies or procedures may be greater for firms that have many personnel or that are geographically dispersed, in order to achieve consistency across the firm.

***Changes in the Nature and Circumstances of the Firm or Its Engagements (Ref: par. 28)***

**A54.** Examples of scalability to demonstrate how policies or procedures for identifying information about changes in the nature and circumstances of the firm and its engagements may vary from other firms include the following:

- In a less complex firm, the firm may have informal policies or procedures to identify information about changes in the nature and circumstances of the firm or its engagements, particularly when the ~~individual or~~ individuals responsible for establishing quality objectives, identifying and assessing quality risks, and designing and implementing responses are able to identify such information in the normal course of their activities.
- In a more complex firm, the firm may need to establish more formal policies or procedures to identify and consider information about changes in the nature and circumstances of the firm or its engagements. This may include, for example, a periodic review of information relating to the nature and circumstances of the firm and its engagements, including ongoing tracking of trends and occurrences in the firm's internal and external environment.

**A55.** Additional quality objectives may need to be established, or quality risks and responses added to or modified, as part of the remedial actions undertaken by the firm to address an identified deficiency in accordance with paragraph 43.

**A56.** The firm may have established quality objectives in addition to those specified by this proposed SQMS. The firm may also identify information that indicates that additional quality objectives previously established by the firm are no longer needed or need to be modified.

## **Governance and Leadership**

### ***Commitment to Quality (Ref: par. 29a)***

**A57.** The firm’s culture is an important factor in influencing the behavior of personnel. Relevant ethical requirements ordinarily establish the principles of professional ethics and are further addressed in the “Relevant Ethical Requirements” section of this proposed SQMS. Professional values and attitudes may include the following:

- Professional manner, for example, timeliness, courteousness, respect, accountability, responsiveness, and dependability
- A commitment to teamwork
- Maintaining an open mind to new ideas or different perspectives in the professional environment
- Pursuit of excellence
- A commitment to continual improvement (for example, setting expectations beyond the minimum requirements and placing a focus on continual learning)
- Social responsibility

**A58.** The firm’s strategic decision-making process, including the establishment of a business strategy, may include matters such as the firm’s decisions about financial and operational matters, the firm’s financial goals, how financial resources are managed, growth of the firm’s market share, industry specialization, or new service offerings. The firm’s financial and operational priorities may directly or indirectly affect the firm’s commitment to quality, for example, the firm may have incentives that are focused on financial and operational priorities that may discourage behaviors that demonstrate a commitment to quality.

### ***Leadership (Ref: par. 29b and 29c)***

**A59.** The responses designed and implemented by the firm to hold leadership responsible and accountable for quality include the performance evaluations required by paragraph 57.

**A60.** Although leadership establishes the tone at the top through its actions and behaviors, clear, consistent, and frequent actions and communications at all levels within the firm collectively contribute to the firm’s culture and demonstrates a commitment to quality.

### ***Organizational Structure (Ref: par. 29d)***

**A61.** The organizational structure of the firm may include operating units, operational processes, divisions, or geographical locations and other structures. In some instances, the firm may concentrate or centralize processes or activities in a service delivery center, and engagement teams may include personnel from the firm’s service delivery center who perform specific tasks that are repetitive or specialized in nature.

### ***Resources (Ref: par. 29e)***

**A62.** The individual or individuals assigned ultimate responsibility and accountability or operational responsibility for the system of quality management are, in most cases, able to influence the nature and extent of resources that the firm obtains, develops, uses, and maintains and how those resources are allocated or assigned, including the timing of when they are used.

**A63.** Because resource needs may change over time, it may not be practicable to anticipate all resource needs. The firm's resource planning may involve determining the resources currently required, forecasting the firm's future resource needs, and establishing processes to deal with unanticipated resource needs when they arise.

**Relevant Ethical Requirements** (Ref: par. 17~~4~~ and 30)

**A64.** The AICPA code sets out the fundamental principles of ethics that provide the framework for the rules that govern the performance of professional responsibilities. The fundamental principles are responsibilities, the public interest, integrity, objectivity and independence, due care, and scope and nature of services. Independence requirements are set forth in the "Independence Rule" (ET sec. 1.200) and related interpretations of the AICPA code and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence and safeguards to mitigate such threats involving matters that are not explicitly addressed in the AICPA code are set forth in the "Conceptual Framework for Independence" (ET sec. 1.210.010).

**A65.** In some cases, the matters addressed by the firm in its system of quality management may be more specific than, or additional to, the provisions of relevant ethical requirements. Examples of matters that a firm may include in its system of quality management that are more specific than, or additional to, the provisions of relevant ethical requirements include the following:

- The firm prohibits the acceptance of gifts and hospitality from a client, even if the value is trivial and inconsequential.
- The firm sets rotation periods for all engagement partners, including those performing attestation, review, and compilation engagements.

**A66.** Other components may affect or relate to the relevant ethical requirements component. Examples of relationships between the relevant ethical requirements component and other components include the following:

- The information and communication component may address the communication of various matters related to relevant ethical requirements, including
  - the firm communicating the independence requirements to all personnel and others subject to independence requirements.
  - personnel and engagement teams communicating relevant information to the firm without fear of reprisals, such as situations that may create threats to independence or breaches of relevant ethical requirements.
- As part of the resources component, the firm may
  - assign individuals to manage and monitor compliance with relevant ethical requirements or to provide consultation on matters related to relevant ethical requirements.

- use IT applications to monitor compliance with relevant ethical requirements, including recording and maintaining information about independence.

**A67.** The relevant ethical requirements that apply to others depend on the provisions of the relevant ethical requirements and how the firm uses others in its system of quality management or in performing engagements. Examples of relevant ethical requirements that apply to others include the following:

- Relevant ethical requirements may include requirements for independence that apply to network firms or employees of network firms, for example, the AICPA code includes independence requirements that apply to network firms.
- Relevant ethical requirements may include a definition of *engagement team* or other similar concept, and the definition may include any individual who performs assurance procedures on the engagement (for example, a service provider engaged to attend a physical inventory count at a remote location). Accordingly, any requirements of the relevant ethical requirements that apply to the engagement team as defined in the relevant ethical requirements, or other similar concept, may also be relevant to such individuals.
- The principle of confidentiality may apply to the firm’s network, other network firms, or service providers when they have access to client information obtained by the firm.

**A68.** AU-C section 600<sup>6</sup> states that when ~~the component auditor is~~ are not subject to the AICPA code, compliance 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.<sup>7</sup> ~~Procedures th~~ The firm may use, for example, regarding the fulfillment of relevant ethical requirements that apply to them by network firms, employees of network firms, or service providers may include confirmations, letters of representation, or other affirmations— from network firms, employees of network firms, or service providers regarding the fulfillment of ethical requirements that are relevant to the firm.

**Commented [AG26]:** To align with AU-C 600.A46 (row 132, 4B)

**Commented [AG27]:** To align more closely with the wording of ET sec. 0.200.020.03 (c)

#### Acceptance and Continuance of Client Relationships and Specific Engagements

##### *The Nature and Circumstances of the Engagement and the Integrity and Ethical Values of the Client (Ref: par. 31a(i))*

**A69.** The information obtained about the nature and circumstances of the engagement may include the following:

<sup>6</sup> Paragraph .A46 of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

<sup>7</sup> The section, “Application of the AICPA Code” (ET sec. 0.200.020), of the AICPA Code of Professional Conduct (AICPA code) explains that an AICPA member who is the group engagement partner ~~of a U.S. consolidated entity should will not~~ be considered ~~in violation of to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA code if a component auditor practicing outside the United States departs from the AICPA code~~ with respect to the audit or review of group financial statements, as long as the component auditor’s conduct, at a minimum, is in accordance provided that component auditors that are not subject to the AICPA code are in compliance with the ethics and independence requirements set forth in the International Ethics Standards Board for Federation of Accountants’ Code of Ethics.

- The industry of the entity for which the engagement is being undertaken and relevant regulatory factors
- The nature of the entity, for example, its operations, organizational structure, ownership and governance, its business model, and how it is financed
- The nature of the underlying subject matter and the applicable criteria, for example, in the case of sustainability reporting:
  - The underlying subject matter may include social, environmental, or health and safety information.
  - The applicable criteria may be performance measures established by a recognized body of ~~experts~~specialists.

**A70.** The information obtained to support the firm’s judgments about the integrity and ethical values of the client may include the identity and business reputation of the client’s principal owners, key management, and those charged with its governance.

**A71.** Examples of factors that may affect the nature and extent of information obtained about the integrity and ethical values of the client include the following:

- The nature of the entity for which the engagement is being performed, including the complexity of its ownership and management structure
- The nature of the client’s operations, including its business practices
- Information concerning the attitude of the client’s principal owners, key management, and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment
- Whether the client is aggressively concerned with keeping the firm’s fees as low as possible
- Indications of a client-imposed limitation in the scope of work
- Indications that the client might be involved in money laundering or other criminal activities
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm
- The identity and business reputation of related parties

**A72.** The firm may obtain the information from a variety of internal and external sources, including the following:

- In the case of an existing client, information from current or previous engagements, if applicable, or inquiry of other personnel who have performed other engagements for the client.
- In the case of a new client, inquiry of existing or previous providers of auditing services to the client, in accordance with relevant ethical requirements.
- Discussions with other third parties, such as bankers, legal counsel, and industry peers.

- Background searches of relevant databases (which may be intellectual resources). In some cases, the firm may use a service provider to perform the background search.

**A73.** Information that is obtained during the firm’s acceptance and continuance process also may often be relevant to the engagement team when planning and performing the engagement. Professional standards may specifically require the engagement team to obtain or consider such information. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>8</sup> requires the engagement partner to take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement.

**A74.** Professional standards or applicable legal and regulatory requirements may include specific provisions that need to be addressed before accepting or continuing a client relationship or specific engagement and may also require the firm to make inquiries of an existing or predecessor firm when accepting an engagement. For example, when there has been a change of auditors, AU-C section 210, *Terms of Engagement*,<sup>9</sup> requires the auditor, prior to starting an initial audit, to request management to authorize the predecessor auditor to respond fully to the auditor’s inquiries regarding matters that will assist the auditor in determining whether to accept the engagement. The AICPA code also addresses consideration of conflicts of interests in accepting or continuing a client relationship or specific engagement (ET sec. 1.110.010).

***The Firm’s Ability to Perform Engagements (Ref: par. 31a(ii))***

**A75.** The firm’s ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements may be affected by the following:

- The availability of appropriate resources to perform the engagement
- Having access to information to perform the engagement or to the persons who provide such information
- Whether the firm and the engagement team are able to fulfill their responsibilities in relation to the relevant ethical requirements

**A76.** Examples of factors the firm may consider in determining whether appropriate resources are available to perform the engagement include the following:

- The circumstances of the engagement and the reporting deadline.
- The availability of individuals with the appropriate competence and capabilities, including sufficient time, to perform the engagement. This includes having
  - individuals to take overall responsibility for directing and supervising the engagement,
  - individuals with knowledge of the relevant industry or the underlying subject matter or criteria to be applied in the preparation of the subject matter information and experience with relevant regulatory or reporting requirements, and

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<sup>8</sup> Paragraph 23 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

<sup>9</sup> Paragraph .11 of AU-C section 210, *Terms of Engagement*.

- individuals to perform audit procedures on the financial information of a component for purposes of an audit of group financial statements.
- The availability of ~~experts~~specialists, if needed.
- If an engagement quality review is needed, whether there is an individual available who meets the eligibility requirements in proposed SQMS *Engagement Quality Reviews*.
- The need for technological resources, for example, IT applications that enable the engagement team to perform procedures on the entity's data.
- The need for intellectual resources, for example, a methodology, industry or subject-matter-specific guides, or access to information sources.

***The Firm's Financial and Operational Priorities (Ref: par. 31b)***

A77. Financial priorities may focus on the profitability of the firm, and fees obtained for performing engagements have an effect on the firm's financial resources. Operational priorities may include strategic focus areas, such as growth of the firm's market share, industry specialization, or new service offerings. There may be circumstances when the firm is satisfied with the fee quoted for an engagement, but it is not appropriate for the firm to accept or continue the engagement or client relationship (for example, when the client lacks integrity and ethical values).

A78. There may be other circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The AICPA code addresses fees and other types of remuneration ([ET section 0.300.030.04](#)).

**Engagement Performance**

***Responsibilities of the Engagement Team and Direction, Supervision, and Review (Ref: par. 32a and 32b)***

A79. Professional standards or applicable legal and regulatory requirements may include specific provisions regarding the overall responsibility of the engagement partner. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* deals with the overall responsibility of the engagement partner for managing and achieving quality on the engagement and for being sufficiently and appropriately involved throughout the engagement, including responsibility for appropriate direction and supervision of the engagement team and review of their work.

A80. Examples of direction, supervision, and review include the following:

- Direction and supervision of the engagement team may include
  - tracking the progress of the engagement,
  - considering the following with respect to members of the engagement team:
    - Whether they understand their instructions

- Whether the work is being carried out in accordance with the planned approach to the engagement
- addressing matters arising during the engagement, considering their significance, and modifying the planned approach appropriately, and
- identifying matters for consultation or consideration by more experienced engagement team members during the engagement.
- A review of work performed may include considering whether
  - the work has been performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements;
  - significant matters have been raised for further consideration;
  - appropriate consultations have been undertaken, and the resulting conclusions have been documented and implemented;
  - there is a need to revise the nature, timing, and extent of planned work;
  - the work performed supports the conclusions reached and is appropriately documented;
  - the evidence obtained for an assurance engagement is sufficient and appropriate to support the report; and
  - the objectives of the engagement procedures have been achieved.

**A81.** In some circumstances, the firm may use personnel from a service delivery center in the firm or individuals from a service delivery center in another network firm to perform procedures on the engagement, (that is, the personnel or other individuals are included in the engagement team). In such circumstances, the firm’s policies or procedures may specifically address the direction and supervision of the individuals and review of their work, such as

- what aspects of the engagement may be assigned to individuals in the service delivery center;
- how the engagement partner, or their designee, is expected to direct, supervise, and review the work undertaken by individuals in the service delivery center; and
- the protocols for communication between the engagement team and individuals in the service delivery center.

***Professional Judgment and Professional Skepticism (Ref: par. 32c)***

**A82.** Professional skepticism supports the quality of judgments made on an assurance engagement and, through these judgments, the overall effectiveness of the engagement team in performing the assurance engagement. Other professional standards may address the exercise of professional judgment or **maintenance of** professional skepticism at the engagement level. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>10</sup> provides examples of impediments to the **exercise**

<sup>10</sup> Paragraphs A27–A29 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

maintenance of professional skepticism at the engagement level, unconscious auditor biases that may impede the ~~exercise~~-maintenance of professional skepticism, and possible actions that the engagement team may take to mitigate such impediments.

**Consultation (Ref: par. 32d)**

**A83.** Consultation typically involves a discussion at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, on difficult or contentious matters. An environment that reinforces the importance and benefit of consultation and encourages engagement teams to consult may contribute to supporting a culture that demonstrates a commitment to quality.

**A84.** Difficult or contentious matters on which consultation is needed may either be specified by the firm, or the engagement team may identify matters that require consultation. The firm may also specify how conclusions should be agreed upon and implemented.

**A85.** Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>11</sup> includes requirements for the engagement partner related to consultation.

**Differences of Opinion (Ref: par. 32e)**

**A86.** The firm may encourage identifying differences of opinion at an early stage and may specify the steps to be taken in raising and dealing with them, including how the matter is to be resolved and how the related conclusions should be implemented and documented. In some circumstances, resolving differences of opinion may be achieved through consulting with another practitioner or firm, or a professional or regulatory body.

**Engagement Documentation (Ref: par. 32f)**

**A87.** Law, regulation, or professional standards may prescribe the time limits by which the assembly of final engagement files for specific types of engagements are to be completed. When no such time limits are prescribed, the time limit may be determined by the firm. For example, the case of engagements conducted in accordance with Statements on Standards for Attestation Engagements (SSAEs) or Statements on Standards for Accounting and Review Services (SSARSS), an appropriate time limit within which to complete the assembly of the final engagement file is ordinarily not more than 60 days after the date of the engagement report.

**A88.** The retention and maintenance of engagement documentation may include managing the safe custody, integrity, accessibility, or retrievability of the underlying data and the related technology. The retention and maintenance of engagement documentation may involve the use of IT applications. The integrity of engagement documentation may be compromised if it is altered, supplemented, or deleted without authorization to do so, or if it is permanently lost or damaged.

**A89.** Law, regulation, or professional standards may prescribe the retention periods for engagement documentation. If the retention periods are not prescribed, the firm may consider the nature of the engagements performed by the firm and the firm's circumstances, including whether

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<sup>11</sup> Paragraph 35 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. In the case of engagements conducted under generally accepted auditing standards or the SSAEs, the retention period is ordinarily no shorter than five years from the date of the engagement report, or, if later, the date of the auditor's report on the group financial statements, when applicable.

**Resources** (Ref: par. 33)

**A90.** Resources for the purposes of the resources component include the following:

- Human resources
- Technological resources, for example, IT applications
- Intellectual resources, for example, written policies or procedures, a methodology, or guides

Financial resources are also relevant to the system of quality management because they are necessary for obtaining, developing, and maintaining the firm's human resources, technological resources, and intellectual resources. Given that the management and allocation of financial resources is strongly influenced by leadership, the quality objectives in governance and leadership, such as those that address financial and operational priorities, address financial resources.

**A91.** Resources may be internal to the firm or may be obtained externally from the firm's network, another network firm, or service provider. Resources may be used in performing activities within the firm's system of quality management or in performing engagements as part of operating the system of quality management. In circumstances when a resource is obtained from the firm's network or another network firm, paragraphs 49–53 form part of the responses designed and implemented by the firm in achieving the objectives in this component.

### ***Human Resources***

*Hiring, Developing, and Retaining Personnel and Personnel Competence and Capabilities* (Ref: par. 33a and d)

**A92.** *Competence* is the ability of the individual to perform a role and goes beyond knowledge of principles, standards, concepts, facts, and procedures; it is the integration and application of technical competence, professional skills, and professional ethics, values, and attitudes. Competence can be developed through a variety of methods, including professional education, continuing professional development, training, work experience, or coaching of less experienced engagement team members by more experienced engagement team members.

**A93.** Law, regulation, or professional standards may establish requirements addressing competence and capabilities. For example, law or regulation may establish requirements for the professional licensing of engagement partners, including requirements regarding their professional education and continuing professional development.

**A94.** The policies or procedures designed and implemented by the firm relating to hiring, developing, and retaining personnel may address, for example, the following:

- Recruiting individuals who have, or are able to develop, appropriate competence
- Training programs focused on developing the competence of personnel and continuing

professional development

- Evaluation mechanisms that are undertaken at appropriate intervals and include competency areas and other performance measures
- Compensation, promotion, and other incentives, for all personnel, including engagement partners and individuals assigned roles and responsibilities related to the firm's system of quality management.

*Personnel's Commitment to Quality and Accountability and Recognition for Commitment to Quality* (Ref: par. 33b)

**A95.** Timely evaluations and feedback help support and promote the continual development of the competence of personnel. Less formal methods of evaluation and feedback may be used, such as in the case of firms with fewer personnel.

**A96.** Positive actions or behaviors demonstrated by personnel may be recognized through various means, such as through compensation, promotion, or other incentives. In some circumstances, simple or informal incentives that are not based on monetary rewards may be appropriate.

**A97.** The manner in which the firm holds personnel accountable for actions or behaviors that negatively affect quality, such as failing to demonstrate a commitment to quality, develop and maintain the competence to perform their role, or implement the firm's responses as designed, may depend on the nature of the action or behavior, including its severity and frequency of occurrence. The following are some actions the firm may take when personnel demonstrate actions or behaviors that negatively affect quality:

- Training or other professional development
- Considering the effect of the matter on the evaluation, compensation, promotion, or other incentives of those involved
- Disciplinary action, if appropriate

*Individuals Obtained From External Sources* (Ref: par. 33c)

**A98.** Professional standards may include responsibilities for the engagement partner regarding the appropriateness of resources. For example, proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>12</sup> addresses the responsibility of the engagement partner for determining that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner in accordance with the firm's policies or procedures.

*Engagement Team Members Assigned to Each Engagement* (Ref: par. 33d)

**A99.** Engagement team members may be assigned to engagements by

- the firm, including assigning personnel from a service delivery center in the firm.

<sup>12</sup> Paragraph 25 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- the firm’s network or another network firm when the firm uses individuals from the firm’s network or another network firm to perform procedures on the engagement (for example, a component auditor or a service delivery center of the network or another network firm).
- a service provider when the firm uses individuals from a service provider to perform procedures on the engagement (for example, a component auditor from a firm not within the firm’s network).

**A100.** Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>13</sup> addresses the responsibility of the engagement partner to determine that members of the engagement team, and any auditor’s external ~~experts~~specialists and internal auditors who provide direct assistance (who are not part of the engagement team), collectively have the appropriate competence and capabilities, including sufficient time, to perform the engagement. The responses designed and implemented by the firm to address the competence and capabilities of engagement team members assigned to the engagement may include policies or procedures that address the following:

- Information that may be obtained by the engagement partner and factors to consider in determining that the engagement team members assigned to the engagement, including those assigned by the firm’s network, another network firm, or service provider, have the competence and capabilities to perform the engagement
- How concerns about the competence and capabilities of engagement team members, in particular, those assigned by the firm’s network, another network firm, or service provider, may be resolved

**A101.** The requirements in paragraphs 49–53 are also applicable when using individuals from the firm’s network or another network firm on an engagement, including component auditors (see, for example, paragraph A190).

***Technological Resources (Ref: par. 33f)***

**A102.** Technological resources, which are typically IT applications, form part of the firm’s IT environment. The firm’s IT environment also includes the supporting IT infrastructure and the IT processes and human resources involved in those processes:

- An IT application is a program or a set of programs that is designed to perform a specific function directly for the user or, in some cases, for another application program.
- The IT infrastructure comprises the IT network, operating systems, and databases and their related hardware and software.
- The IT processes are the firm’s processes to manage access to the IT environment, program changes or changes to the IT environment, and IT operations, which includes monitoring the IT environment.

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<sup>13</sup> Paragraph 26 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

**A103.** A technological resource may serve multiple purposes within the firm, and some of the purposes may be unrelated to the system of quality management. Technological resources that are relevant for the purposes of this proposed SQMS are as follows:

- Technological resources that are directly used in designing, implementing, or operating the firm’s system of quality management
- Technological resources that are used directly by engagement teams in performing engagements
- Technological resources that are essential to enabling the effective operation of the preceding, such as, in relation to an IT application, the IT infrastructure and IT processes supporting the IT application

**A104.** Examples of scalability to demonstrate how the technological resources that are relevant for the purposes of this proposed SQMS may differ in firms of different complexity include the following:

- In a less complex firm, the technological resources may comprise a commercial IT application used by engagement teams, which has been purchased from a service provider. The IT processes that support the operation of the IT application may also be relevant, although they may be simple (for example, processes for authorizing access to the IT application and processing updates to the IT application).
- In a more complex firm, the technological resources may be more complex and may comprise the following:
  - Multiple IT applications, including custom-developed applications or applications developed by the firm’s network, such as
    - IT applications used by engagement teams (for example, engagement software and automated audit tools)
    - IT applications developed and used by the firm to manage aspects of the system of quality management (for example, IT applications to monitor independence or assign personnel to engagements)
  - The IT processes that support the operation of these IT applications, including the individuals responsible for managing the IT infrastructure and processes and the firm’s processes for managing program changes to IT applications

**A105.** The firm may consider the following matters in obtaining, developing, implementing, and maintaining an IT application:

- The data inputs are complete and appropriate.
- Confidentiality of the data is preserved.
- The IT application operates as designed and achieves the purpose for which it is intended.
- The outputs of the IT application achieve the purpose for which they will be used.
- The general IT controls necessary to support the IT application’s continued operation as designed are appropriate.

- The need for specialized skills to use the IT application effectively, including the training of individuals who will use the IT application.
- The need to develop procedures that set out how the IT application operates.

**A106.** The firm may specifically prohibit the use of IT applications or features of IT applications until such time that it has been determined that they operate appropriately and have been approved for use by the firm. Alternatively, the firm may establish policies or procedures to address circumstances when the engagement team uses an IT application that is not approved by the firm. Such policies or procedures may require the engagement team to determine that the IT application is appropriate for use prior to using it on the engagement, through considering the matters in paragraph A102. Proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*<sup>14</sup> addresses the engagement partner’s responsibilities for engagement resources.

***Intellectual Resources (Ref: par. 33g)***

**A107.** Intellectual resources include the information the firm uses to enable the operation of the system of quality management and promote consistency in performing engagements. Examples of intellectual resources include written policies or procedures, a methodology, industry or subject-matter-specific guides, accounting guides, standardized documentation, or access to information sources (for example, subscriptions to websites that provide in-depth information about entities or other information that is typically used in performing engagements).

**A108.** Intellectual resources may be made available through technological resources, for example, the firm’s methodology may be embedded in the IT application that facilitates the planning and performance of the engagement.

***Use of Technological and Intellectual Resources (Ref: par. 33f–g)***

**A109.** The firm may establish policies or procedures regarding the use of the firm’s technological and intellectual resources. Examples of such policies or procedures include the following:

- Requiring the use of certain IT applications or intellectual resources in performing engagements, or relating to other aspects of the engagement, such as in archiving the engagement file
- Specifying the qualifications or experience that individuals need to use the resource, including the need for an **expertspecialist** or training, for example, the firm may specify the qualifications or expertise needed to use an IT application that analyzes data, given that specialized skills may be needed to interpret the results
- Specifying the responsibilities of the engagement partner regarding the use of technological and intellectual resources
- Setting out how the technological or intellectual resources are to be used, including how individuals should interact with an IT application or how the intellectual resource

<sup>14</sup> Paragraphs 25–28 of proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

should be applied, and the availability of support or assistance in using the technological or intellectual resource

***Service Providers (Ref: par. 17\* and 33h)***

**A110.** In some circumstances, the firm may use resources that are provided by a service provider, particularly in circumstances when the firm does not have access to the appropriate resources internally. Notwithstanding that a firm may use resources from a service provider, the firm remains responsible for its system of quality management.

**A111.** Examples of resources from a service provider include the following:

- Individuals engaged to perform the firm’s monitoring activities or engagement quality reviews, or to provide consultation on technical matters
- A commercial IT application used to perform audit engagements
- Individuals performing procedures on the firm’s engagements, for example, component auditors from firms not within the firm’s network or individuals engaged to attend a physical inventory count at a remote location
- An auditor’s external specialist used by the firm to assist the engagement team in obtaining audit evidence

**A112.** In identifying and assessing quality risks, the firm is required to obtain an understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives, which includes conditions, events, circumstances, actions, or inactions relating to service providers. In doing so, the firm may consider the nature of the resources provided by service providers, how and the extent to which they will be used by the firm, and the general characteristics of the service providers used by the firm (for example, the varying types of other professional services firms that are used) to identify and assess quality risks related to the use of such resources.

**A113.** In determining whether a resource from a service provider is appropriate for use in the firm’s system of quality management or performing engagements, the firm may obtain information about the service provider and the resource it provides from a number of sources. The following are matters the firm may consider:

- The related quality objective and quality risks. For example, in the case of a methodology from a service provider, there may be quality risks related to the quality objective in paragraph 33g, such as a quality risk that the service provider does not update the methodology to reflect changes in professional standards and applicable legal and regulatory requirements.
- The nature and scope of the resources and the conditions of the service (for example, in relation to an IT application, how often updates will be provided, limitations on the use of the IT application, and how the service provider addresses confidentiality of data).
- The extent to which the resource is used across the firm, how the resource will be used by the firm, and whether it is suitable for that purpose.
- The extent of customization of the resource for the firm.

- The firm’s previous use of the service provider.
- The service provider’s experience in the industry and reputation in the market.
- The results of assurance engagements performed by independent third parties on the resource (for example, assurance engagements on quality control materials or reports on service organization controls).

**A114.** The firm may have a responsibility to take further actions in using the resource from a service provider so that the resource functions effectively. For example, the firm may need to communicate information to the service provider in order for the resource to function effectively, or, in relation to an IT application, the firm may need to have supporting IT infrastructure and IT processes in place.

**A115.** The evaluation of a service provider from a firm not within the firm’s network that is used as a component auditor may be different than that of a service provider engaged directly by the firm. For example, in understanding the competency of the component auditor to perform the engagement, it may not be necessary or practicable for the firm to obtain an understanding of how the component auditor updates its methodology to reflect changes in professional standards. Rather, the firm could perform procedures such as review of results of regulatory inspections, transparency or audit quality information published by the component auditor’s firm, or evaluation of the reputation of the component auditor.

**Information and Communication (Ref: par. 34)**

**A116.** Obtaining, generating, or communicating information is generally an ongoing process that involves all personnel and encompasses the dissemination of information within the firm and externally. Information and communication are pervasive to all components of the system of quality management.

***The Firm’s Information System (Ref: par. 34a)***

**A117.** Reliable and relevant information includes information that is accurate, complete, timely, and valid to enable the proper functioning of the firm’s system of quality management and to support decisions regarding the system of quality management.

**A118.** The information system may include the use of manual or IT elements, which affect the manner in which information is identified, captured, processed, maintained, and communicated. The procedures to identify, capture, process, maintain, and communicate information may be enforced through IT applications, and in some cases, may be embedded within the firm’s responses for other components. In addition, digital records may replace or supplement physical records.

**A119.** An example of scalability is that less complex firms with fewer personnel and direct involvement of leadership may not need rigorous policies and procedures that specify how information should be identified, captured, processed, and maintained.

***Communication Within the Firm (Ref: par. 34b–c)***

**A120.** The firm may recognize and reinforce the responsibility of personnel and engagement teams to exchange information with the firm and one another by establishing communication

channels to facilitate communication across the firm. Examples of communication among the firm, engagement teams, and other individuals include the following:

- The firm communicates the responsibility for implementing the firm’s responses to personnel and engagement teams.
- The firm communicates changes to the system of quality management to personnel and engagement teams to the extent that the changes are relevant to their responsibilities and enables personnel and engagement teams to take prompt and appropriate action in accordance with their responsibilities.
- The firm communicates information that is obtained during the firm’s acceptance and continuance process that is relevant to engagement teams in planning and performing engagements.
- Engagement teams communicate the following information to the firm:
  - Information about the client that is obtained during the performance of an engagement that may have caused the firm to decline the client relationship or specific engagement had that information been known prior to accepting or continuing the client relationship or specific engagement.
  - Information about the operation of the firm’s responses (for example, concerns about the firm’s processes for assigning personnel to engagements), which, in some cases, may indicate a deficiency in the firm’s system of quality management.
- Engagement teams communicate information to the engagement quality reviewer or individuals providing consultation.
- Group engagement teams communicate matters to component auditors in accordance with the firm’s policies or procedures, including matters related to quality management at the engagement level.
- The **individual or** individuals assigned operational responsibility for compliance with independence requirements communicate to relevant personnel and engagement teams changes in the independence requirements and the firm’s policies or procedures to address such changes.

#### ***Communication With External Parties***

*Communication to or Within the Firm’s Network and to Service Providers* (Ref: par. 34d(i))

**A121.** In addition to the firm communicating information to or within the firm’s network or to a service provider, the firm may need to obtain information from the network, a network firm, or a service provider that supports the firm in the design, implementation, and operation of its system of quality management. For example, the firm may obtain information from the network or other network firms about clients of other network firms when there are independence requirements that affect the firm.

*Communication With Others External to the Firm* (Ref: par. 34d(ii))

**A122.** Examples of when law, regulation, or professional standards may require the firm to communicate information to external parties include the following:

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- The firm becomes aware of noncompliance with laws and regulations by a client, and relevant ethical requirements require the firm to report the noncompliance with laws and regulations to an appropriate authority outside the client entity or to consider whether such reporting is an appropriate action in the circumstances.
- Law or regulation requires the firm to publish a transparency report and specifies the nature of the information that is required to be included in the transparency report.
- Securities law or regulation requires the firm to communicate certain matters to those charged with governance.

**Commented [AG28]:** Are these relevant in the US? (Row 134, 4B)

**Commented [AG29R28]:** TaLK to Teighlor

Paragraphs A131–A135 address communications to support external parties’ understanding of the system of quality management beyond those required by law, regulation, or professional standards.

**A123.** In some cases, law or regulation may preclude the firm from communicating information related to its system of quality management externally. Examples of when the firm may be precluded from communicating information externally include the following:

- Confidentiality law or regulation prohibits disclosure of certain information.
- Law, regulation, or relevant ethical requirements include provisions addressing the duty of confidentiality.

**Specified Responses** (Ref: par. 35)

**A124.** The specified responses may address multiple quality risks related to more than one quality objective across different components. For example, policies or procedures for complaints and allegations may address quality risks related to quality objectives in resources (for example, personnel’s commitment to quality), relevant ethical requirements, and governance and leadership.

~~The specified responses alone are not sufficient to achieve the objectives of the system of quality management.~~

**Commented [AG30]:** Moved to par. 27 as essential guidance. See row 135 in agenda item 4B

**Relevant Ethical Requirements** (Ref: par. 35a–b)

**A125.** Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be addressed. For example, the AICPA code provides a conceptual framework for this purpose and, in applying the conceptual framework, requires that the firm use the reasonable and informed third-party test.

**A126.** Relevant ethical requirements may specify how the firm is required to respond to a breach. For example, the “Breach of an Independence” interpretation (ET sec. 1.298.010) of the “Independence Rule” (ET sec. 1.200.001) contains guidance addressing a breach of an independence interpretation of the AICPA code, which also contains guidance addressing a breach of any other provision of the AICPA code.

**A127.** Matters the firm may address relating to breaches of the relevant ethical requirements include the following:

- The communication of breaches of the relevant ethical requirements to appropriate personnel

- The evaluation of the significance of a breach and its effect on compliance with relevant ethical requirements
- The actions to be taken to satisfactorily address the consequences of a breach, including that such actions be taken as soon as practicable
- Determining whether to report a breach to external parties, such as those charged with governance of the entity to which the breach relates or an external oversight authority
- Determining the appropriate actions to be taken in relation to the individual or individuals responsible for the breach

***Complaints and Allegations (Ref: par. 35c)***

**A128.** Establishing policies or procedures for dealing with complaints and allegations may assist the firm in preventing engagement reports from being issued that are inappropriate. It also may assist the firm in

- identifying and dealing with individuals, including leadership, who do not act or behave in a manner that demonstrates a commitment to quality and supports the firm’s commitment to quality, or
- identifying deficiencies in the system of quality management.

**A129.** Complaints and allegations may be made by personnel or others external to the firm (for example, clients, component auditors, or individuals within the firm’s network).

***Information That Becomes Known Subsequent to Accepting or Continuing a Client Relationship or Specific Engagement (Ref: par. 35d)***

**A130.** Information that becomes known subsequent to accepting or continuing a client relationship or specific engagement may

- have existed at the time of the firm’s decision to accept or continue the client relationship or specific engagement, and the firm was not aware of such information, or
- relate to new information that has arisen since the decision to accept or continue the client relationship or specific engagement.

**A131.** Examples of matters addressed in the firm’s policies or procedures for circumstances in which information becomes known subsequent to accepting or continuing a client relationship or specific engagement that may have affected the firm’s decision to accept or continue a client relationship or specific engagement include the following:

- Undertaking consultation within the firm or with legal counsel
- Considering whether there is a professional, legal, or regulatory requirement for the firm to continue the engagement
- Discussing with the appropriate level of the client’s management and with those charged with governance or the engaging party the action that the firm might take based on the relevant facts and circumstances
- When it is determined that withdrawal is an appropriate action:

- Informing the client’s management and those charged with governance or the engaging party of this decision and the reasons for the withdrawal
- Considering whether there is a professional, legal, or regulatory requirement for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities

**A132.** In some circumstances, law or regulation may impose an obligation on the firm to accept or continue a client engagement.

**A133.** Examples of matters addressed in the firm’s policies or procedures in circumstances in which the firm is obligated to accept or continue an engagement or the firm is unable to withdraw from an engagement, and the firm is aware of information that would have caused the firm to decline or discontinue the engagement, include the following:

- The firm considers the effect of the information on the performance of the engagement.
- The firm communicates the information to the engagement partner and requests the engagement partner to increase the extent and frequency of the direction and supervision of the engagement team members and review of their work.
- The firm assigns more experienced personnel to the engagement.
- The firm determines that an engagement quality review should be performed.

***Communication With External Parties (Ref: par: 35e)***

**A134.** The firm’s ability to maintain stakeholder confidence in the quality of its engagements may be enhanced through relevant, reliable, and transparent communication by the firm about the activities that it has undertaken to address quality and the effectiveness of those activities.

**A135.** External parties who may use information about the firm’s system of quality management, and the extent of their interest in the firm’s system of quality management, may vary based on the nature and circumstances of the firm and its engagements.

**A136.** Examples of external parties who may use information about the firm’s system of quality management include the following:

- Management or those charged with governance of the firm’s clients may use the information to determine whether to appoint the firm to perform an engagement.
- External oversight authorities may have indicated a desire for the information to support their responsibilities in monitoring the quality of engagements across a jurisdiction and in understanding the work of firms.
- Other firms who use the work of the firm in performing engagements (for example, in relation to a group audit) may have requested such information.
- Other users of the firm’s engagement reports, such as investors who use engagement reports in their decision making, may have indicated a desire for the information.

**A137.** The information about the system of quality management provided to external parties, including information communicated to those charged with governance about how the system of

quality management supports the consistent performance of quality engagements, may address such matters as the following:

- The nature and circumstances of the firm, such as the organizational structure, business model, strategy, and operating environment
- The firm’s governance and leadership, such as its culture, how it demonstrates a commitment to quality, and assigned roles, responsibilities, and authority with respect to the system of quality management
- How the firm fulfills its responsibilities in accordance with relevant ethical requirements, including those related to independence
- Factors that contribute to quality engagements, for example, such information may be presented in the form of engagement quality indicators with narrative to explain the indicators
- The results of the firm’s monitoring activities and external inspections and how the firm has remediated identified deficiencies or is otherwise responding to them
- The evaluation undertaken in accordance with paragraphs 54–55 of whether the system of quality management provides the firm with reasonable assurance that the objectives of the system are being achieved and the conclusion thereon, including the basis for the judgments made in evaluating and concluding
- How the firm has responded to emerging developments and changes in the circumstances of the firm or its engagements, including how the system of quality management has been adapted to respond to such changes
- The relationship between the firm and the network, the overall structure of the network, a description of network requirements and network services, the responsibilities of the firm and the network (including that the firm is ultimately responsible for the system of quality management), and information about the overall scope and results of network monitoring activities across the network firms

*Determining When It Is Appropriate to Communicate With External Parties* (Ref: par. 35e(i))

**A138.** The firm’s determination of when it is appropriate to communicate with external parties about the firm’s system of quality management is a matter of professional judgment and may be influenced by matters such as the following:

- The types of engagements performed by the firm
- The types of entities for which such engagements are undertaken, for example, entities that may have public interest or public accountability characteristics, such as
  - entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders, including financial institutions, such as certain banks, insurance companies, and pension funds
  - entities with a high public profile or whose management or owners have a high public profile
  - entities with a large number and wide range of stakeholders.

- The nature and circumstances of the firm
- The nature of the firm’s operating environment, such as customary business practice in the firm’s jurisdiction and the characteristics of the financial markets in which the firm operates
- The extent to which the firm has already communicated with external parties in accordance with law or regulation (that is, whether further communication is needed, and if so, the matters to be communicated)
- The expectations of stakeholders in the firm’s jurisdiction, including the understanding and interest that external parties have expressed about the engagements undertaken by the firm, and the firm’s processes in performing the engagements
- Jurisdictional trends
- The information that is already available to external parties
- How external parties may use the information, and their general understanding of matters related to firms’ system of quality management and engagements performed by the firm in its accounting and auditing practice
- The public interest benefits of external communication and whether it would reasonably be expected to outweigh the costs (monetary or otherwise) of such communication

The preceding matters may also affect the information provided by the firm in the communication and the nature, timing, and extent and appropriate form of communication.

**A139.** AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*, deals with the auditor’s responsibility to communicate with those charged with governance in an audit of financial statements and addresses the auditor’s determination of the appropriate person or persons within the entity’s governance structure with whom to communicate<sup>15</sup> and the communication process.<sup>16</sup> In some circumstances, it may be appropriate to include information about the firm’s system of quality management in those communications with those charged with governance (or when performing other engagements, for example, review or examination engagements). How the communication with those charged with governance is undertaken (that is, by the firm or the engagement team) may depend on the firm’s policies or procedures and the circumstances of the engagement.

#### ***Considerations for Engagements for Governmental Organizations***

**A140.** The firm may determine it is appropriate to communicate to those charged with governance of a governmental organization about how the firm’s system of quality management supports the consistent performance of quality engagements, taking into account the size and complexity of the governmental organization, the range of its stakeholders, the nature of the services it provides, and the roles and responsibilities of those charged with governance.

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<sup>15</sup> Paragraphs .07–.09 of AU-C section 260, *The Auditor’s Communication With Those Charged With Governance*.

<sup>16</sup> Paragraphs .15–.20 of AU-C section 260.

*Nature, Timing, and Extent and Appropriate Form of Communication With External Parties* (Ref: par: 35e(ii))

**A141.** The firm may consider the following attributes in preparing information that is communicated to external parties:

- The information is specific to the circumstances of the firm. Relating the matters in the firm’s communication directly to the specific circumstances of the firm may help to minimize the potential that such information becomes overly standardized and less useful over time.
- The information is presented in a clear and understandable manner, and the manner of presentation is neither misleading nor would inappropriately influence the users of the communication (for example, the information is presented in a manner that is appropriately balanced towards positive and negative aspects of the matter being communicated).
- The information is accurate and complete in all material respects and does not contain information that is misleading.
- The information takes into consideration the information needs of the users for whom it is intended. In considering the information needs of the users, the firm may consider matters such as the level of detail that users would find meaningful and whether users have access to relevant information through other sources (for example, the firm’s website).

**A142.** The firm uses professional judgment in determining, in the circumstances, the appropriate form of communication with the external party, including communication with those charged with governance when performing an audit of financial statements of listed entities, which may be made orally or in writing. Accordingly, the form of communication may vary.

Examples of forms of communication to external parties include the following:

- A publication such as a transparency report or audit quality report
- Targeted written communication to specific stakeholders (for example, information about the results of the firm’s monitoring and remediation process)
- Direct conversations and interactions with the external party (for example, discussions between the engagement team and those charged with governance)
- A web page
- Other forms of digital media, such as social media, or interviews or presentations via webcast or video

***Engagements Subject to an Engagement Quality Review***

*Engagement Quality Review Required by Law or Regulation* (Ref: par. 35f(i))

**A143.** Law or regulation may require an engagement quality review to be performed, for example, for audit engagements for entities that

- are *public interest entities* as defined in a particular jurisdiction,

- are governmental organizations or recipients of government funding, or entities with public accountability,
- operate in certain industries (for example, financial institutions such as banks, insurance companies, and pension funds),
- meet a specified asset threshold, or
- are under the management of a court or judicial process (for example, liquidation).

*Engagement Quality Review as a Response to Address One or More Quality Risks* (Ref: par. 35f(ii))

**A144.** The firm’s understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives as required by paragraph 26a(ii), relates to the nature and circumstances of the engagements performed by the firm. In designing and implementing responses to address one or more quality risks, the firm may determine that an engagement quality review is an appropriate response based on the reasons for the assessments given to the quality risks.

**A145.** Criteria established by the firm to determine whether an engagement ~~quality control~~ review is an appropriate response for one or more quality risks may relate to the types of engagements performed by the firm and reports to be issued, and the types of entities for which engagements are undertaken. Examples of conditions, events, circumstances, actions, or inactions giving rise to such quality risks include the following:

Commented [LS31]: Row 139, 4B

Those relating to the types of engagements performed by the firm and reports to be issued:

- Engagements that involve a high level of complexity or judgment, such as the following:
  - Audits of financial statements for entities operating in an industry that typically has accounting estimates with a high degree of estimation uncertainty (for example, certain large financial institutions or mining entities) or for entities for which uncertainties exist related to events or conditions that may cast significant doubt on their ability to continue as a going concern
  - Assurance engagements that require specialized skills and knowledge in measuring or evaluating the underlying subject matter against the applicable criteria (for example, a greenhouse gas statement in which there are significant uncertainties associated with the quantities reported therein)
- Engagements on which issues have been encountered, such as audit engagements with recurring internal or external inspection findings, unremediated significant deficiencies in internal control, or a material restatement of comparative information in the financial statements
- Engagements for which unusual circumstances have been identified during the firm’s acceptance and continuance process (for example, a new client that had a disagreement with its previous auditor or assurance practitioner).
- Engagements that involve reporting on financial or nonfinancial information that is expected to be included in a regulatory filing, and that may involve a higher degree of

judgment, such as pro forma financial information to be included in a prospectus

Those relating to the types of entities for which engagements are undertaken:

- Entities in emerging industries or for which the firm has no previous experience.
- Entities for which concerns were expressed in communications from regulators.
- Entities that may have public interest or public accountability characteristics, for example:
  - Entities that hold a significant amount of assets in a fiduciary capacity for a large number of stakeholders, including financial institutions, such as certain banks, insurance companies, and pension funds for which an engagement quality review is not otherwise required by law or regulation
  - Entities with a high public profile or whose management or owners have a high public profile
  - Entities with a large number and wide range of stakeholders
  - Governmental organizations
    - Due to their size and complexity, the range of their stakeholders or the nature of the services they provide
    - Due to the complexity, and importance to users, of additional reporting requirements established by law or regulation (for example, a separate report on instances of noncompliance with law or regulation to the legislature or other governing body or communicating such instances in the auditor's report on the financial statements).

**A146.** The firm's responses to address quality risks may include other forms of engagement reviews that are not an engagement quality review. For example, for audits of financial statements, the firm's responses may include reviews of the engagement team's procedures relating to significant risks, or reviews of certain significant judgments, by personnel who have specialized technical expertise. In some cases, these other types of engagement reviews may be undertaken in addition to an engagement quality review.

**A147.** In some cases, the firm may determine that there are no audits or other engagements for which an engagement quality review or another form of engagement review is an appropriate response to address the quality risks.

#### **Monitoring and Remediation Process** (Ref: par. 36–48)

**A148.** In addition to enabling the evaluation of the system of quality management, the monitoring and remediation process facilitates the proactive and continual improvement of engagement quality and the system of quality management. Examples follow:

- Given the inherent limitations of a system of quality management, the firm's identification of deficiencies is not unusual, and it is an important aspect of the system of quality management because prompt identification of deficiencies enables the firm

to remediate them in a timely and effective manner and contributes to a culture of continual improvement.

- The monitoring activities may provide information that enables the firm to prevent a deficiency through responding to a finding that could, over a period of time, lead to a deficiency.

***Designing and Performing Monitoring Activities (Ref: par. 38–39)***

**A149.** The firm’s monitoring activities may comprise a combination of ongoing monitoring activities and periodic monitoring activities. Ongoing monitoring activities are generally routine activities built into the firm’s processes and performed on a real-time basis. Periodic monitoring activities are conducted at certain intervals by the firm. In most cases, ongoing monitoring activities provide information about the system of quality management in a timelier manner.

**A150.** Monitoring activities may include the inspection of in-process engagements. Inspections of engagements are designed to monitor whether an aspect of the system of quality management is designed, implemented, and operating in the manner intended. In some circumstances, the system of quality management may include responses that are designed to review engagements while they are in the process of being performed that appear similar in nature to an inspection of in-process engagements (for example, reviews that are designed to detect failures or shortcomings in the system of quality management so that they can prevent a quality risk from occurring). The purpose of the activity drives its design and implementation and where it fits within the system of quality management (that is, whether it is an inspection of an in-process engagement that is a monitoring activity or a review of an engagement that is a response to address a quality risk).

**A151.** The nature, timing, and extent of the monitoring activities may also be affected by other matters, including

- the size, structure, and organization of the firm.
- the involvement of the firm’s network in monitoring activities.
- the resources that the firm intends to use to enable monitoring activities, such as the use of IT applications.

**A152.** When performing monitoring activities, the firm may determine that changes to the nature, timing, and extent of the monitoring activities are needed, such as when findings indicate the need for more extensive monitoring activities.

*The Design of the Firm’s Risk Assessment Process and Monitoring and Remediation Process*  
(Ref: par. 38c)

**A153.** How the firm’s risk assessment process is designed (for example, a centralized or decentralized process, or the frequency of review) may affect the nature, timing, and extent of the monitoring activities, including monitoring activities over the firm’s risk assessment process.

**A154.** How the firm’s monitoring and remediation process is designed (that is, the nature, timing, and extent of the monitoring and remediation activities, taking into account the nature and circumstances of the firm) may affect the monitoring activities undertaken by the firm to determine whether the monitoring and remediation process is achieving the intended purpose as described in paragraph 36.

**A155.** An example of scalability to demonstrate how the monitoring activities for the monitoring and remediation process may differ in firms of different complexity is as follows:

- In a less complex firm, the monitoring activities may be simple because information about the monitoring and remediation process may be readily available in the form of leadership’s knowledge, based on their frequent interaction with the system of quality management, of the nature, timing, and extent of the monitoring activities undertaken, the results of the monitoring activities, and the firm’s actions to address the results.
- In a more complex firm, the monitoring activities for the monitoring and remediation process may be specifically designed to determine that the monitoring and remediation process is providing relevant, reliable, and timely information about the system of quality management, and responding appropriately to identified deficiencies.

*Changes in the System of Quality Management* (Ref: par. 38d)

**A156.** Changes in the system of quality management may include

- changes to address an identified deficiency in the system of quality management.
- changes to the quality objectives, quality risks, or responses as a result of changes in the nature and circumstances of the firm and its engagements.

When changes occur, previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system of quality management and, therefore, the firm’s monitoring activities may include monitoring of those areas of change.

*Previous Monitoring Activities* (Ref: par. 38e and 44b)

**A157.** The results of the firm’s previous monitoring activities may indicate areas of the system where a deficiency may arise, particularly areas where there is a history of identified deficiencies.

**A158.** Previous monitoring activities undertaken by the firm may no longer provide the firm with information to support the evaluation of the system, including on areas of the system of quality management that have not changed, particularly when time has elapsed since the monitoring activities were undertaken.

*Other Relevant Information* (Ref: par. 17~~h~~ and 38f)

**A159.** In addition to the sources of information indicated in paragraph 38f, other relevant information may include the following:

- Information communicated by the firm’s network in accordance with paragraphs 51c and 52b about the firm’s system of quality management, including the network requirements or network services that the firm has included in its system of quality management
- Information communicated by a service provider about the resources the firm uses in its system of quality management
- Information from regulators about the entities for whom the firm performs engagements, which is made available to the firm, such as information from a securities

regulator about an entity for whom the firm performs engagements (for example, irregularities in the entity's financial statements)

**A160.** The results of external inspections or other relevant information, both internal and external, may indicate that previous monitoring activities undertaken by the firm failed to identify a deficiency in the system of quality management. This information may affect the firm's consideration of the nature, timing, and extent of the monitoring activities.

**A161.** External inspections are not a substitute for the firm's internal monitoring activities. Nevertheless, the results of external inspections inform the nature, timing, and extent of the monitoring activities.

***Engagement Inspections (Ref: par. 39)***

**A162.** Examples of matters in paragraph 38 that may be considered by the firm in selecting completed engagements for inspection include the following:

- In relation to the conditions, events, circumstances, actions, or inactions giving rise to the quality risks:
  - The types of engagements performed by the firm, and the extent of the firm's experience in performing the type of engagement
  - The types of entities for which engagements are undertaken, for example:
    - Entities operating in emerging industries
    - Entities operating in industries associated with a high level of complexity or judgment
    - Entities operating in an industry that is new to the firm
  - The tenure and experience of engagement partners
- The results of previous inspections of completed engagements, including for each engagement partner
- In relation to other relevant information:
  - Complaints or allegations about an engagement partner
  - The results of external inspections, including for each engagement partner
  - The results of the firm's evaluation of each engagement partner's commitment to quality

**A163.** The firm may undertake multiple monitoring activities, other than inspection of completed engagements, that focus on determining whether engagements have complied with policies or procedures. These monitoring activities may be undertaken on certain engagements or engagement partners. The nature and extent of these monitoring activities, and the results, may be used by the firm in determining the following:

- How often to select completed engagements ~~to select~~ for inspection, and which completed engagements to select, based on the factors described in paragraph A159

- Which engagement partners to select for inspection, and how frequently to select an engagement partner for inspection, based on factors such as how long it has been since the engagement partner was subject to inspection, the results of previous inspections of the engagement partner, or the engagement partner’s experience with performing engagements at different levels of service, in new industries, or with complex financial reporting matters
- Which aspects of the engagement to consider when performing the inspection of completed engagements

For example, if the firm has undertaken inspections of in-process engagements

- the firm may determine it appropriate to reduce the extent of selection of completed engagements for inspection;
- the results of the inspections of in-process engagements may indicate areas of risk that may affect which completed engagements are selected for inspection; or
- the results of the inspections of in-process engagements may identify negative quality issues that prompt the firm to shorten the inspection cycle or expand the extent of completed engagement inspections.

**A164.** The inspection of completed engagements for engagement partners on a cyclical basis may assist the firm in monitoring whether engagement partners have fulfilled their overall responsibility for managing and achieving quality on the engagements to which they are assigned.

**A165.** Examples of policies and procedures that a firm may establish to apply a cyclical basis for the inspection of completed engagements for each engagement partner include the following policies or procedures that

- set forth the standard period of the inspection cycle, such as the inspection of a completed engagement for each engagement partner performing audits of financial statements once every, for example, three years, and for all other engagement partners, once every, for example, five years.
- set out the criteria for selecting completed engagements, including that for an engagement partner performing audits of financial statements, the engagements selected include an audit engagement.
- address the selection of engagement partners in a manner that is unpredictable.
- address when it is necessary or appropriate to select engagement partners more, or less, frequently than the standard period set out in the policy. Examples follow:
  - The firm may select engagement partners more frequently than the standard period set out in the firm’s policy when
    - multiple deficiencies have been identified by the firm that have been evaluated as severe, and the firm determines that a more frequent cyclical inspection is needed across all engagement partners.
    - the engagement partner performs engagements for entities operating in a certain industry in which there are high levels of complexity or judgment.

Commented [AG32]: See row 144 of agenda item 4B

- an engagement performed by the engagement partner has been subject to other monitoring activities, and the results of the other monitoring activities were unsatisfactory.
  - the engagement partner has performed an engagement for an entity operating in an industry in which the engagement partner has limited experience.
  - the engagement partner has limited experience in performing that level of service engagements.
  - the engagement partner is a newly appointed engagement partner or has recently joined the firm from another firm or another jurisdiction.
- The firm may defer the selection of the engagement partner (for example, deferring for a year beyond the standard period set out in the firm’s policy) when
- engagements performed by the engagement partner have been subject to other monitoring activities during the standard period set out in the firm’s policy, and
  - the results of the other monitoring activities provide sufficient information about the engagement partner, that is, performing the inspection of completed engagements would unlikely provide the firm with further information about the engagement partner.

**A166.** The matters considered in an inspection of an engagement depend on how the inspection will be used to monitor the system of quality management. Ordinarily, the inspection of an engagement includes determining that responses that are implemented at the engagement level (for example, the firm’s policies and procedures in respect of engagement performance) have been implemented as designed and are operating effectively.

*The Relationship of Peer Review to Monitoring*

**A167.** A peer review is not a substitute for all monitoring ~~procedures~~activities. However, because the objective of a peer review is similar to that of an inspection ~~procedures~~, a-the firm’s quality ~~control~~management policies ~~and or~~ procedures may provide that a peer review conducted under standards established by the AICPA may be a substitute for the inspection of engagement documentation, reports, and clients’ financial statements for some or all engagements for the period covered by the peer review.

Commented [AG33]: See row 145 of agenda item 4B.

A167A. A peer review may result in findings or deficiencies. However, the definitions of findings and deficiencies in this proposed standard are different than the definitions of those terms in AICPA Standards for Performing and Reporting on Peer Reviews.<sup>1</sup> Accordingly, findings and deficiencies may be evaluated differently for peer review purposes than for purposes of this standard. Findings or deficiencies identified in a firm’s system of quality management may not necessarily result in a peer review finding or deficiency; similarly, peer review findings or deficiencies may not necessarily equate to findings or deficiencies in a firm’s system of quality management. As with other items identified in the firm’s monitoring

<sup>1</sup> Paragraphs 70 and 110 of *AICPA Standards for Performing and Reporting on Peer Reviews (Professional Standards, AICPA, PRP section 1000)*.

activities, the firm would need to assess any peer review findings or deficiencies to determine the impact on the firm’s evaluation of its system of quality management.

**Commented [AG34]:** See row 17 of agenda item 4B. Adapted from wording provided by the Peer Review team

*Individuals Performing the Monitoring Activities (Ref: par. 40b)*

**A168.** ~~The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs an inspection of an engagement was an engagement team member or the engagement quality reviewer of that engagement. A self-review threat may also arise when an individual who participated in the response to a quality risk, is performing the monitoring of that response~~another type of monitoring activity participated in designing, executing, or operating the response being monitored.~~ For example, a self-review threat may arise if an engagement partner who is responsible for client acceptance at the engagement level or at the firm level is also responsible for monitoring compliance with the firm’s client acceptance policies and procedures.~~

**Commented [AG35]:** Revised by the Task Force as part of not precluding self-inspection. Changed wording of “designing, executing or operating” because the Task Force does not agree that designing a response and then monitoring that response creates a self-review threat.

**A169.** ~~an inspection of an engagement was in the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period, or for all other engagements, an engagement team member or the engagement quality reviewer of that engagement.~~

**A168.** ~~another type of monitoring activity participated in designing, executing, or operating the response being monitored.~~

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**A169.** In some circumstances, for example, in the case of a less complex firm, there may not be personnel who have the competence, capabilities, time, or objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities. This standard does not preclude an individual from performing monitoring activities, including inspections, of their own compliance with a quality management system. However, such self-inspections may be less effective than compliance inspections by another qualified individual. When an individual inspects their own compliance with the firm’s policies and procedures, the firm has a higher risk that noncompliance with policies and procedures will not be detected or reported. To effectively monitor one’s own compliance, it is necessary that an individual be able to critically review their own performance, assess their own strengths and weaknesses, and maintain an attitude of continual improvement.

**Commented [AG36]:** As discussed at the 12/2/21 ASB meeting

**A170.** Responses that may provide safeguards against the self-review threat and lessen the likelihood of deficiencies in the system of quality management include the following actions:~~In some circumstances, for example, in the case of a less complex firm, there may not be personnel who have the competence, capabilities, time, or objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities.~~

- Fostering a commitment to continuing professional education and providing effective training programs so that personnel stay current on accounting, auditing, and quality management standards

- Providing training on how to perform monitoring inspections and requiring the use of peer review or other inspection checklists
- Requiring the passage of time after the completion of an engagement before self-inspections are performed

A170A. The firm may have responses in place to address other quality risks that may be particularly helpful when self-inspections are performed, such as the following actions:

- Establishing strong client acceptance and engagement continuance policies that provide reasonable assurance that the firm doesn't accept or retain engagements it doesn't have the competency and resources to perform
- Establishing consultation policies that provide reasonable assurance engagement teams will consult when they encounter technical accounting and auditing difficulties
- Taking corrective action in response to the results identified by the firm's internal monitoring, peer review results or other external inspections, for example, inspections by the U.S. Department of Labor
- Requiring the use of an external service provider to perform engagement quality reviews or monitoring procedures when
  - deficiencies identified by the firm's peer reviewers or other external inspections indicate that self-inspection is not effective
  - changes in conditions and the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) occur

**Commented [AG37]:** Revised to clarify that these are responses that may be in place to address other quality risks

#### ***Evaluating Findings and Identifying Deficiencies (Ref: par. 17# and 41–42)***

**A171.** The firm accumulates findings from the performance of monitoring activities, external inspections, and other relevant sources. Information accumulated by the firm from the monitoring activities, external inspections, and other relevant sources may reveal other observations about the firm's system of quality management, such as

- actions, behaviors, or conditions that have given rise to positive outcomes in the context of quality or the effectiveness of the system of quality management, or
- similar circumstances in which no findings were noted (for example, engagements in which no findings were noted, and the engagements have a similar nature to the engagements in which findings were noted).

Other observations may be useful to the firm because they may assist the firm in investigating the root causes of identified deficiencies, indicate practices that the firm can support or apply more extensively (for example, across all engagements), or highlight opportunities for the firm to enhance the system of quality management.

**A172.** The firm exercises professional judgment in determining whether findings, individually or in combination with other findings, give rise to a deficiency in the system of quality management. In making the judgment, the firm may need to take into account the relative importance of the findings in the context of the quality objectives, quality risks, responses, or other aspects of the

system of quality management to which they relate. The firm's judgments may be affected by quantitative and qualitative factors relevant to the findings. In some circumstances, the firm may determine it appropriate to obtain more information about the findings in order to determine whether a deficiency exists. Not all findings, including engagement findings, will be a deficiency.

**A173.** Examples of quantitative and qualitative factors that a firm may consider in determining whether findings give rise to a deficiency include the following:

*Quality risks and responses*

- If the findings relate to a response:
  - How the response is designed, for example, the nature of the response, the frequency of its occurrence (if applicable), and the relative importance of the response to addressing the quality risks and achieving the quality objectives to which it relates
  - The nature of the quality risk to which the response relates and the extent to which the findings indicate that the quality risk has not been addressed
  - Whether there are other responses that address the same quality risk and whether there are findings for those responses

*Nature of the findings and their pervasiveness*

- The nature of the findings. For example, findings related to leadership actions and behaviors may be qualitatively significant, given the pervasive effect this could have on the system of quality management as a whole.
- Whether the findings, in combination with other findings, indicate a trend or systemic issue. For example, similar engagement findings that appear on multiple engagements may indicate a systemic issue.

*Extent of Monitoring Activity and Extent of Findings*

- The extent of the monitoring activity from which the findings arose, including the number or size of the selections.
- The extent of the findings in relation to the selection covered by the monitoring activity and in relation to the expected deviation rate. For example, in the case of inspection of engagements, the number of engagements selected in which the findings were identified, relative to the total number of engagements selected, and the expected deviation rate set by the firm.

**A174.** Evaluating findings and identifying deficiencies and evaluating the severity and pervasiveness of an identified deficiency, including investigating the root causes of an identified deficiency, are part of an iterative and nonlinear process. Examples follows:

- In investigating the root causes of an identified deficiency, the firm may identify a circumstance that has similarities to other circumstances in which there were findings that were not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and classifies them as deficiencies.

- In evaluating the severity and pervasiveness of an identified deficiency, the firm may identify a trend or systemic issue that correlates with other findings that are not considered deficiencies. As a result, the firm adjusts its evaluation of the other findings and also classifies them as deficiencies.

**A175.** The results of monitoring activities, results of external inspections, and other relevant information (for example, network monitoring activities or complaints and allegations) may reveal information about the effectiveness of the monitoring and remediation process. For example, the results of external inspections may provide information about the system of quality management that has not been identified by the firm’s monitoring and remediation process, which may highlight a deficiency in that process.

***Evaluating Identified Deficiencies (Ref: par. 42)***

**A176.** Factors the firm may consider in evaluating the severity and pervasiveness of an identified deficiency include the following:

- The nature of the identified deficiency, including the aspect of the firm’s system of quality management to which the deficiency relates, and whether the deficiency is in the design, implementation, or operation of the system of quality management
- In the case of identified deficiencies related to responses, whether there are compensating responses to address the quality risk to which the response relates
- The root causes of the identified deficiency
- The frequency with which the matter giving rise to the identified deficiency occurred
- The magnitude of the identified deficiency, how quickly it occurred, and the duration of time that it existed and had an effect on the system of quality management

**A177.** The severity and pervasiveness of identified deficiencies affects the evaluation of the system of quality management that is undertaken by the individual or individuals assigned ultimate responsibility and accountability for the system of quality management.

***Root Cause of the Identified Deficiencies (Ref: par. 42a)***

**A178.** The objective of investigating the root causes of identified deficiencies is to understand the underlying circumstances that caused the deficiencies to enable the firm to

- evaluate the severity and pervasiveness of the identified deficiency and
- appropriately remediate the identified deficiency.

Performing a root cause analysis involves the exercise of professional judgment based on the evidence available by those performing the assessment.

**A179.** The nature, timing, and extent of the procedures undertaken to understand the root causes of an identified deficiency may also be affected by the nature and circumstances of the firm, such as the following:

- The complexity and operating characteristics of the firm.
- The size of the firm.
- The geographical dispersion of the firm.

- How the firm is structured or the extent to which the firm concentrates or centralizes its processes or activities. For example, in the case of a less complex firm with a single location, the firm’s procedures to understand the root causes of a deficiency may be simple because the information to inform the understanding may be readily available and concentrated, and the root causes may be more apparent. In the case of a more complex firm with multiple locations, the procedures to understand the root causes of a deficiency may include using individuals specifically trained on investigating the root causes of identified deficiencies and developing a methodology with more formalized procedures for identifying root causes.
- The nature of the identified deficiency, for example, the firm’s procedures to understand the root causes of an identified deficiency may be more rigorous in circumstances when an engagement report related to an audit of financial statements was issued that was inappropriate, or the identified deficiency relates to leadership’s actions and behaviors regarding quality.
- The possible severity of the identified deficiency, for example, the firm’s procedures to understand the root causes of an identified deficiency may be more rigorous in circumstances when the deficiency has been identified across multiple engagements, or there is an indication that policies or procedures have high rates of noncompliance.

**A180.** In investigating the root causes of identified deficiencies, the firm may consider why deficiencies did not arise in other circumstances that are of a similar nature to the matter to which the identified deficiency relates. Such information may also be useful in determining how to remediate an identified deficiency. For example, the firm may determine that a deficiency exists because similar findings have occurred across multiple engagements. However, the findings have not occurred in several other engagements within the same population being tested. By contrasting the engagements, the firm concludes that the root cause of the identified deficiency is a lack of appropriate involvement by the engagement partners at key stages of the engagements.

**A181.** Identifying root causes that are appropriately specific may support the firm’s process for remediating identified deficiencies. For example, the firm may identify that engagement teams performing audits of financial statements are failing to obtain sufficient appropriate audit evidence on accounting estimates when management’s assumptions have a high degree of subjectivity. Although the firm notes that these engagement teams are not ~~exereising-maintaining~~ appropriate professional skepticism, the underlying root cause of this issue may relate to another matter, such as a cultural environment that does not encourage engagement team members to question individuals with greater authority or insufficient direction, supervision, and review of the work performed on the engagements.

**A182.** In addition to investigating the root causes of identified deficiencies, the firm may also investigate the root causes of positive outcomes because doing so may reveal opportunities for the firm to improve, or further enhance, the system of quality management.

***Responding to Identified Deficiencies (Ref: par. 43)***

**A183.** The nature, timing, and extent of remedial actions may depend on a variety of other factors, including the following:

- The root causes

- The severity and pervasiveness of the identified deficiency and, therefore, the urgency with which it needs to be addressed
- The effectiveness of the remedial actions in addressing the root causes, such as whether the firm needs to implement more than one remedial action in order to effectively address the root causes, or needs to implement remedial actions as interim measures until the firm is able to implement more effective remedial actions

**A184.** In some circumstances, the remedial action may include establishing additional quality objectives, or quality risks or responses may be added or modified, because it is determined that they are not appropriate.

**A185.** In circumstances when the firm determines that the root cause of an identified deficiency relates to a resource provided by a service provider, the firm may also

- consider whether to continue using the resource provided by the service provider.
- communicate the matter to the service provider.

The firm is responsible for addressing the effect of the identified deficiency related to a resource provided by a service provider on the system of quality management and taking action to prevent the deficiency from recurring with respect to the firm's system of quality management. However, the firm is not ordinarily responsible for remediating the identified deficiency on behalf of the service provider or further investigating the root cause of the identified deficiency at the service provider.

*Findings About a Particular Engagement (Ref: par. 46)*

**A186.** AU-C section 585, *Consideration of Omitted Procedures After the Report Release Date*, addresses the auditor's responsibilities in circumstances when procedures were omitted, or the report issued is inappropriate. In such circumstances relating to other assurance and attest engagements, the action taken by the firm may include the following:

- Consulting with appropriate individuals regarding the appropriate action
- Discussing the matter with management of the entity or those charged with governance
- Performing the omitted procedures

The actions taken by the firm do not relieve the firm of the responsibility to take further actions relating to the finding in the context of the system of quality management, including evaluating the findings to identify deficiencies and, when a deficiency exists, investigating the root causes of the identified deficiency.

***Ongoing Communication Related to the Monitoring and Remediation (Ref: par. 47)***

**A187.** The information communicated about the monitoring and remediation to the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may be communicated on an ongoing basis or periodically. The individual or individuals may use the information in multiple ways. Examples follow:

- As a basis for further communications to personnel about the importance of quality
- To hold individuals accountable for their roles assigned to them
- To identify key concerns about the system of quality management in a timely manner

The information also provides a basis for the evaluation of the system of quality management, and conclusion thereon, as required by paragraphs 54–56.

**Network Requirements or Network Services** (Ref: par. 49)

**A188.** In some circumstances, the firm may belong to a network. Networks may establish requirements regarding the firm’s system of quality management or may make services or resources available that the firm may choose to implement or use in the design, implementation, and operation of its system of quality management. Such requirements or services may be intended to promote the consistent performance of quality engagements across the firms that belong to the network. The extent to which the network will provide the firm with quality objectives, quality risks, and responses that are common across the network will depend on the firm’s arrangements with the network.

**A189.** Examples of network requirements include the following:

- Requirements for the firm to include additional quality objectives or quality risks in the firm’s system of quality management that are common across the network firms.
- Requirements for the firm to include responses in the firm’s system of quality management that are common across the network firms. Such responses designed by the network may include network policies or procedures that specify the leadership roles and responsibilities, including how the firm is expected to assign authority and responsibility within the firm, or resources, such as network-developed methodologies for performing engagements or IT applications.
- Requirements that the firm be subject to the network’s monitoring activities. These monitoring activities may relate to network requirements (for example, monitoring that the firm has implemented the network’s methodology appropriately) or to the firm’s system of quality management in general.

**A190.** Examples of network services include services or resources that are optional for the firm to use in its system of quality management or in performing engagements, such as voluntary training programs, use of component auditors or ~~experts~~specialists from within the network, or use of a service delivery center established at the network level, or by another network firm or group of network firms.

Commented [AG38]: To conform to GAAS wording

**A191.** The network may establish responsibilities for the firm in implementing the network requirements or network services. Examples follow:

- The firm is required to have certain IT infrastructure and IT processes in place to support an IT application provided by the network that the firm uses in the system of quality management.
- The firm is required to provide firm-wide training on the methodology provided by the network, including when updates are made to the methodology.

**A192.** The firm’s understanding of the network requirements or network services and the firm’s responsibilities relating to the implementation thereof may be obtained through inquiries of, or documentation provided by, the network about matters such as the following:

- The network’s governance and leadership

- The procedures undertaken by the network in designing, implementing, and, if applicable, operating, the network requirements or network services
- How the network identifies and responds to changes that affect the network requirements or network services or other information, such as changes in the professional standards or information that indicates a deficiency in the network requirements or network services
- How the network monitors the appropriateness of the network requirements or network services, which may include through the network firms’ monitoring activities, and the network’s processes for remediating identified deficiencies

***Network Requirements or Network Services in the Firm’s System of Quality Management***  
**(Ref: par. 50)**

**A193.** The characteristics of the network requirements or network services are a condition, event, circumstance, action, or inaction in identifying and assessing quality risks. An example of a network requirement or network service that gives rise to a quality risk is as follows.

The network may require the firm to use an IT application for the acceptance and continuance of client relationships and specific engagements that is standardized across the network. This may give rise to a quality risk that the IT application does not address matters in local law or regulation that need to be considered by the firm in accepting and continuing client relationships and specific engagements.

**A194.** The purpose of the network requirements may include the promotion of consistent performance of quality engagements across the network firms. The firm may be expected by the network to implement the network requirements; however, the firm may need to adapt or supplement the network requirements such that they are appropriate for the nature and circumstances of the firm and its engagements.

**A195.** Examples of how the network requirements or networks services may need to be adapted or supplemented include the following:

<i>Network requirement or network service</i>	<i>How the firm adapts or supplements the network requirement or network service</i>
The network requires the firm to include certain quality risks in the system of quality management, so that all firms in the network address the quality risks. The network does not provide an assessment of the quality risks.	As part of identifying and assessing quality risks, the firm assesses the quality risks that are required by the network.  The firm also designs and implements responses to address the assessed quality risks that are required by the network.

<p>The network requires that the firm design and implement certain responses.</p>	<p>As part of designing and implementing responses, the firm determines</p> <ul style="list-style-type: none"> <li>• which assessed quality risks the responses address.</li> <li>• how the responses required by the network will be incorporated into the firm’s system of quality management, given the nature and circumstances of the firm. This may include tailoring the response to reflect the nature and circumstances of the firm and the engagements performed by the firm (for example, tailoring a methodology to include matters related to law or regulation).</li> </ul>
<p><u>The firm uses individuals from other network firms as component auditors. Network requirements are in place that drive a high degree of commonality across the network firms’ systems of quality management. The network requirements include specific criteria that apply to individuals assigned to work on a component for a group audit.</u></p>	<p><u>The firm establishes policies or procedures that require the engagement team to confirm with the component auditor (that is, the other network firm) that the individuals assigned to the component meet the specific criteria set out in the network requirements.</u></p>

**Commented [AG39]:** See row 152, item 4B. From ISQM 1.

**A196.** In some circumstances, in adapting or supplementing the network requirements or network services, the firm may identify possible improvements to the network requirements or network services and may communicate these improvements to the network.

***Monitoring Activities Undertaken by the Network on the Firm’s System of Quality Management (Ref: par. 51c)***

**A197.** The results of the network’s monitoring activities of the firm’s system of quality management may include information such as the following:

- A description of the monitoring activities, including their nature, timing, and extent

- Findings, identified deficiencies, and other observations about the firm’s system of quality management (for example, positive outcomes or opportunities for the firm to improve, or further enhance, the system of quality management)
- The network’s evaluation of the root causes of the identified deficiencies, the assessed effect of the identified deficiencies, and recommended remedial actions

***Monitoring Activities Undertaken by the Network Across the Network Firms (Ref: par. 52b)***

**A198.** The information from the network about the overall results of the network’s monitoring activities undertaken across the network firms’ systems of quality management may be an aggregation or summary of the information described in paragraph A193, including trends and common areas of identified deficiencies across the network, or positive outcomes that may be replicated across the network. Such information may

- be used by the firm
  - in identifying and assessing quality risks.
  - as part of other relevant information considered by the firm in determining whether deficiencies exist in the network requirements or network services used by the firm in its system of quality management.
- be communicated to group engagement partners, in the context of considering the competence and capabilities of component auditors from a network firm who are subject to common network requirements (for example, common quality objectives, quality risks, and responses).

**A199.** In some circumstances, the firm may obtain information from the network about deficiencies identified in a network firm’s system of quality management that affects the firm. The network may also gather information from network firms regarding the results of external inspections over network firms’ systems of quality management. In some instances, law or regulation in a particular jurisdiction may prevent the network from sharing information with other network firms or may restrict the specificity of such information.

**A200.** In circumstances when the network does not provide the information about the overall results of the network’s monitoring activities across the network firms, the firm may take further actions, such as

- discussing the matter with the network, and
- determining the effect on the firm’s engagements and communicating the effect to engagement teams.

***Deficiencies in Network Requirements or Network Services Identified by the Firm (Ref: par. 53)***

**A201.** As network requirements or network services used by the firm form part of the firm’s system of quality management, they are also subject to the requirements of this proposed SQMS regarding monitoring and remediation. The network requirements or network services may be monitored by the network, the firm, or a combination of both; for example, a network may undertake monitoring activities at a network level for a common methodology. The firm may also

monitor the application of the methodology by engagement team members through performing engagement inspections.

**A202.** In designing and implementing the remedial actions to address the effect of the identified deficiency in the network requirements or network services, the firm may

- understand the planned remedial actions by the network, including whether the firm has any responsibilities for implementing the remedial actions, and
- consider whether supplementary remedial actions need to be taken by the firm to address the identified deficiency and the related root causes, such as when
  - the network has not taken appropriate remedial actions, or
  - the network’s remedial actions will take time to effectively address the identified deficiency.

**Evaluating the System of Quality Management (Ref: par. 54)**

**A203.** The individual or individuals assigned ultimate responsibility and accountability for the system of quality management may be assisted by other individuals in performing the evaluation. Nevertheless, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management remain responsible and accountable for the evaluation.

**A204.** The point in time at which the evaluation is undertaken may depend on the circumstances of the firm and may coincide with the fiscal year-end of the firm or the completion of an annual monitoring cycle.

**A205.** The information that provides the basis for the evaluation of the system of quality management includes the information communicated to the individuals assigned ultimate responsibility and accountability for the system of quality management in accordance with paragraph 47.

**A206.** An example of scalability to demonstrate how the information that provides the basis for the evaluation of the system of quality management may be obtained in firms of different complexity is as follows:

- In a less complex firm, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may be directly involved in the monitoring and remediation and, therefore, will be aware of the information that supports the evaluation of the system of quality management.
- In a more complex firm, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may need to establish processes to collate, summarize, and communicate the information needed to evaluate the system of quality management.

**Concluding on the System of Quality Management (Ref: par. 55)**

**A207.** In the context of this proposed SQMS, it is intended that the operation of the system as a whole provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved. In concluding on the system of quality management, the

individual or individuals assigned ultimate responsibility and accountability for the system of quality management may, in using the results of the monitoring and remediation process, consider the following:

- The severity and pervasiveness of identified deficiencies and the effect on the achievement of the objectives of the system of quality management
- Whether remedial actions have been designed and implemented by the firm and whether the remedial actions taken up to the time of the evaluation are effective
- Whether the effect of identified deficiencies on the system of quality management have been appropriately corrected, such as whether further actions have been taken in accordance with paragraph 46

**A208.** There may be circumstances when identified deficiencies that are severe (including identified deficiencies that are severe and pervasive) have been appropriately remediated and the effect of them corrected at the point in time of the evaluation. In such cases, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved.

**A209.** An identified deficiency may have a pervasive effect on the design, implementation, and operation of the system of quality management when, for example

- the deficiency affects several components or aspects of the system of quality management.
- the deficiency is confined to a specific component or aspect of the system of quality management but is fundamental to the system of quality management.
- the deficiency affects several business units or geographical locations of the firm.
- the deficiency is confined to a business unit or geographical location, but the business unit or location affected is fundamental to the firm overall.
- the deficiency affects a substantial portion of engagements that are of a certain type or nature.

**A210.** An example of an identified deficiency that may be considered severe but not pervasive is as follows:

The firm identifies a deficiency in one of its smaller regional offices. The identified deficiency relates to noncompliance with many firm policies or procedures. The firm determines that the culture in the regional office, particularly the actions and behavior of leadership in the regional office, which were overly focused on financial priorities, has contributed to the root cause of the identified deficiency. The firm determines that the effect of the identified deficiency is as follows:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures
- Not pervasive, because it is limited to the smaller regional office

**A211.** The individual or individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that the system of quality management does not

provide the firm with reasonable assurance that the objectives of the system of quality management are being achieved in circumstances when identified deficiencies are severe and pervasive, actions taken to remediate the identified deficiencies are not appropriate, and the effect of the identified deficiencies have not been appropriately corrected.

**A212.** An example of an identified deficiency that may be considered severe and pervasive is as follows:

The firm identifies a deficiency in a regional office, which is the firm’s largest office and provides financial, operational, and technical support for the entire region. The identified deficiency relates to noncompliance with many firm policies or procedures. The firm determines that the culture in the regional office, particularly the actions and behavior of leadership in the regional office, which were overly focused on financial priorities, has contributed to the root cause of the identified deficiency. The firm determines that the effect of the identified deficiency is as follows:

- Severe, because it relates to the culture of the regional office and overall compliance with firm policies or procedures
- Pervasive, because the regional office is the largest office and provides support to many other offices, and the noncompliance with firm policies or procedures may have had a broader effect on the other offices

**A213.** It may take time for the firm to remediate identified deficiencies that are severe and pervasive. As the firm continues to take action to remediate the identified deficiencies, the pervasiveness of the identified deficiencies may be diminished, and it may be determined that the identified deficiencies are still severe but no longer severe and pervasive. In such cases, the individual or individuals assigned ultimate responsibility and accountability for the system of quality management may conclude that, except for matters related to identified deficiencies that have a severe but not pervasive effect on the design, implementation, and operation of the system of quality management, the system of quality management provides the firm with reasonable assurance that the objectives of the system of quality management are being achieved.

**A214.** This proposed SQMS does not require the firm to obtain an independent assurance report (for example, a peer review report) on its system of quality management annually or preclude the firm from doing so.

Commented [AG40]: See 4B row 153

***Taking Prompt and Appropriate Action and Further Communication (Ref: par. 56)***

**A215.** In circumstances when the individual or individuals assigned ultimate responsibility and accountability for the system of quality management reach the conclusion described in paragraph 54b or 54c, the prompt and appropriate action taken by the firm may include the following:

- Taking measures to support performing engagements through assigning more resources or developing more guidance and to confirm that reports issued by the firm are appropriate in the circumstances, until such time as the identified deficiencies are remediated, and communicating such measures to engagement teams
- Obtaining legal advice

**A216.** In some circumstances, the firm may have an independent governing body that has nonexecutive oversight of the firm. In such circumstances, communications may include informing the independent governing body.

**A217.** Examples of circumstances in which it may be appropriate for the firm to communicate to external parties about the evaluation of the system of quality management include the following:

- When the firm belongs to a network
- When other network firms use the work performed by the firm, for example, in the case of a group audit
- When a report issued by the firm is determined by the firm to be inappropriate as a result of the failure of the system of quality management, and management or those charged with governance of the entity need to be informed
- When law or regulation requires the firm to communicate to an oversight authority or a regulatory body

***Performance Evaluations (Ref: par. 57)***

**A218.** Periodic performance evaluations promote accountability. In considering the performance of an individual, the firm may take the following into account:

- The results of the firm’s monitoring activities for aspects of the system of quality management that relate to the responsibility of the individual. In some circumstances, the firm may set targets for the individual and measure the results of the firm’s monitoring activities against those targets.
- The actions taken by the individual in response to identified deficiencies that relate to the responsibility of that individual, including the timeliness and effectiveness of such actions.

**A219.** An example of scalability to demonstrate how firms of different complexity may undertake the performance evaluations is as follows:

- In a less complex firm, the firm may engage a service provider to perform the evaluation, or the results of the firm’s monitoring activities may provide an indication of the performance of the individual.
- In a more complex firm, the performance evaluations may be undertaken by an independent nonexecutive member of the firm’s governing body or a special committee overseen by the firm’s governing body.

**A220.** A positive performance evaluation may be rewarded through compensation, promotion, and other incentives that focus on the individual’s commitment to quality and reinforce accountability. On the other hand, the firm may take corrective actions to address a negative performance evaluation that may affect the firm’s achievement of its quality objectives.

***Documentation (Ref: par. 58–60)***

**A221.** Documentation provides evidence that the firm complies with this proposed SQMS, as well as law, regulation, or relevant ethical requirements. It may also be useful for training personnel and engagement teams, ensuring the retention of organizational knowledge, and providing a history of the basis for decisions made by the firm about its system of quality management. It is neither necessary nor practicable for the firm to document every matter considered, or judgment

made, about its system of quality management. Furthermore, compliance with this proposed SQMS may be evidenced by the firm through its information and communication component, documents or other written materials, or IT applications that are integral to the components of the system of quality management.

**A222.** Documentation may be formal (for example, written manuals, checklists, and forms), informal (for example, email communication or postings on websites), or held in IT applications or other digital forms (for example, in databases). Factors that may affect the firm's judgments about the form, content, and extent of documentation, including how often documentation is updated, may include the following:

- The complexity of the firm and the number of offices
- The nature and complexity of the firm's practice and organization
- The nature of engagements the firm performs and the nature of the entities for whom engagements are performed
- The nature and complexity of the matter being documented, such as whether it relates to an aspect of the system of quality management that has changed or an area of greater quality risk, and the complexity of the judgments relating to the matter
- The frequency and extent of changes in the system of quality management

In a less complex firm, it may not be necessary to have documentation supporting matters communicated because informal communication methods may be effective. Nevertheless, a less complex firm may determine it appropriate to document such communications in order to provide evidence that they occurred.

**A223.** In some instances, an external oversight authority may establish documentation requirements, either formally or informally, for example, as a result of the outcome of external inspection findings. Relevant ethical requirements may also include specific requirements addressing documentation, for example, the AICPA code requires documentation of particular matters, including certain situations related to conflicts of interest, noncompliance with laws and regulations, and independence.

**A224.** The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction for each quality objective or each risk that may give rise to a quality risk. However, in documenting the quality risks and how the firm's responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (that is, the considered occurrence and effect on the achievement of one or more quality objectives) to support the consistent implementation and operation of the responses.

**A225.** The documentation may be provided by the network, other network firms, or other structures or organizations within the network.

### QM 1 Detailed Comments<sup>1</sup>

Row	CL	Par.	Feedback	Task Force Comment
1	121	overall	1b. We agree with the fundamental aspects of the proposed SQMS No.1, including the components of the system of quality management and the integration of the components. We appreciate the changes to expand resources to include technological and intellectual resources, the emphasis on the responsibility of firm leadership for proactively managing quality, the importance of a continuous flow of information and communication, more robustly addressing monitoring activities and understanding network requirements.	Noted
2	144	overall	I generally feel that the new and enhanced components are reasonable. The suggestion of implementation guidance related to monitoring and remediation would be greatly appreciated.	Noted
3	089	overall	The committees felt that the requirements and application material are generally clear, with the exception of comments on specific sections as listed below. With the newness of this approach for many firms, additional non-authoritative guidance, training and practice aids on how to do a risk-based approach will be important. Resources will need to be developed that include directional advice for firms of various sizes to assist in complying with the requirements.	Noted
4	160	Note	<p>The proposed standards include several paragraphs that reference the proposed QM SAS standard and other audit related guidance for the relevant topics. I suspect this is the case because auditing standards address those elements in its literature, while other standards do not.</p> <p>I believe quality management standards should be an overarching set of standards that are applicable to all levels of service. In areas such as partner involvement, partner responsibilities, and independence, discussion is presented that only indicates applicability to audit engagements. I believe these concepts are relevant to all levels of service and the materials should address the concepts in that fashion. Given my view that QM standards are overarching, there is no need to have these elements addressed in the</p>	Noted

<sup>1</sup> List of CL respondents was provided as agenda item 4A in the materials for the October ASB meeting (<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/asb/downloadabledocuments/202110-asb-item4a.pdf>)

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			separate standards, unless there is a specific additional need under that level of service. QM standards should indicate the concept that applies to all engagements and need not reference other standards. This would make it less confusing for practitioners and help achieve a higher level of quality.	
5	143	1	<p>Paragraph 1 D&amp;T believes that the reference to “its” in the first scope paragraph should be clarified, as it is not otherwise immediately apparent whose accounting and auditing practice is being referenced.</p> <p>1. This proposed Statement on Quality Management Standards (SQMS) deals with a firm’s responsibilities to design, implement, and operate a system of quality management for <del>its</del> <u>the firm’s</u> accounting and auditing practice.</p>	Consistent with extant use of “its”; no change.
6	061	3	SQMS No. 1, paragraphs 3, A98, and A100, address partner involvement through reference to auditing standards, presumably due to the inclusion of such relevant guidance in those standards, and a lack thereof in other standards. However, this gives the implication that those concepts are only relevant to audit engagements. We believe those three paragraphs should be removed as the quality management standards do not need to replicate other standards. Instead, we believe SQMS No. 1 is an independent standard that applies to all engagements, as indicated in paragraph 6. Verbiage should be added instead to emphasize that matter and provide guidance for all engagements.	Moved paragraph A1 into par. 3 to counterbalance.
7	074	5	However, we suggest the ASB explicitly address the likelihood that government audit organizations performing audits in accordance with Governmental Auditing Standards (i.e., Yellow Book) will follow the Government Accountability Office’s (GAO) quality management (QM) standards, instead of both the GAO’s QM and the ASB’s proposed SQMS: A Firm’s System of Quality Management. Because GAO does not incorporate by reference the ASB’s quality management standards, we suggest the ASB address in the scope (or application guidance for the scope) for the government environment that government audit organizations, for example, need not apply the ASB QM standard when the government audit organization is required by law, rule, regulation, or policy to follow the GAO quality control standards in the Yellow Book. The reason for this exemption is that complying with both QM standards (GAO and ASB) could be inconsistent and overly burdensome. As an analogy, COSO and Green Book are both listed as acceptable internal control frameworks for which the ASB recommends following one framework, not both (even though they are consistent).	Par. 5 states that government audit organizations don’t have to follow SQMS 1 or SQMS 2.
8	143	5	The bullets below describe our comments relating to the application of the proposed QM standards within the context of GAS, including whether there are differences when an	

		<p>engagement is being conducted in accordance with generally accepted government auditing standards (GAGAS) either by a firm or a government audit organization. We believe that, where specific reference is being made to the foundations and principles in GAS or requirements for complying with GAS, it would be appropriate to explicitly footnote the references to the relevant chapters in GAS as issued by the United States Government Accountability Office (GAO). Unless these footnote references are included in proposed SQMS No. 1, the basis for the statements in paragraph 5 of proposed SQMS No. 1 when engagements are being conducted in accordance with GAGAS is unclear. Our recommended changes are provided below.</p> <ul style="list-style-type: none"> <li>• We do not believe it is necessary for the phrase “CPA firms” in paragraph 5 of proposed SQMS No. 1 to be used, as it introduces confusion as to whether the phrase “CPA firm” differs from “firm” as defined in paragraph 17 of proposed SQMS No 1. Further, there is only one instance of the use of the phrase “CPA firm” in the proposed QM standards. Chapter 1.12 of GAS provides examples of the various types of users who may be required to or may elect to use GAGAS, which includes certified public accounting firms. Consequently, providing the appropriate reference to GAS provides sufficient context for the use of “firm.” Our recommended changes are provided below.</li> <li>• Paragraph 5 of proposed SQMS No. 1 notes that the “proposed SQMS applies to audit and attestation engagements performed by CPA firms in accordance with Government Auditing Standards.” While it is clear in chapter 5 that GAS sets quality control and assurance requirements for [government] audit organizations conducting engagements in accordance with GAGAS, it is not as clear as to the applicability of proposed SQMS No. 1 when the firm is conducting the following engagements in accordance with GAGAS: (a) financial audits, (b) attestation engagements, and (c) reviews of financial statements. Chapters 6.01 and 7.01 in GAS note that GAGAS incorporates by reference the AICPA’s SASs, SSAEs, and AR-C section 90, Review of Financial Statements. Supplemental amendments to proposed SQMS No. 1 specific to paragraph A20 of AU-C section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards, and paragraph 6 of AT-C section 105, Concepts Common to All Attestation Engagements, reference proposed SQMS No. 1, thereby inferring the applicability of the proposed QM standards when an engagement is being conducted by the firm in accordance with GAGAS.</li> </ul>	<ul style="list-style-type: none"> <li>• Agree</li>   <li>• This is from extant. No change.</li>   <li>• This has been in the QC standards since at least 2006. GAO is not aware of</li> </ul>
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			<p>D&amp;T proposes that the ASB collaborate with the GAO to develop a technical interpretation to clearly articulate the applicability of proposed SQMS No. 1 when conducting the aforementioned engagements in accordance with GAGAS. One additional area where clarification is sought pertains to the statement in paragraph 5 of proposed SQMS No. 1 that “[it] does not apply to government audit organizations.” As previously highlighted, chapter 5 of the GAS addresses the quality control and peer review of [government] audit organizations, but it would appear that the GAS professional literature is silent as to the exemption of government audit organizations from proposed SQMS No. 1. D&amp;T recommends that the basis for this statement be provided as a footnote reference. We recommend the following edits be made to paragraph 5 relating to the first and second bullets:</p> <p>5. This proposed SQMS applies to <b><u>the firm performing financial audits, -and attestation-level examination, review, and agreed-upon procedures engagements or reviews of financial statements performed by CPA firms in accordance with generally accepted government auditing standards (collectively, “engagements conducted in accordance with GAGAS”) (footnote 1, footnote 2).</u></b> This proposed SQMS does not apply to government audit organizations. Instead, those government audit organizations are subject to the quality control and assurance requirements of Government Auditing Standards <b><u>(footnote 3).</u></b></p> <p><b><u>Footnote 1: Chapter 1.12 b, Government Auditing Standards (GAS).</u></b></p> <p><b><u>Footnote 2: Chapter 1.16, GAS.</u></b></p> <p><b><u>Footnote 3: Chapter 5, GAS.</u></b></p> <ul style="list-style-type: none"> <li>• In addition to the edits to paragraph 5 of proposed SQMS No. 1 noted above, we recommend the ASB separately address the observations outlined in the third and fourth bullets regarding the applicability of proposed SQMS No. 1 to firms for engagements conducted in accordance with GAGAS and the basis of the stated exemption of government audit organizations from proposed SQMS No. 1.</li> </ul>	<p>difficulties in practice in applying this.</p>
9	040	10	Paragraph 10 of Proposed Statement on Quality Management Standards (SQMS) No. 1, Quality Management: A Firm’s System of Quality Management, reads as follows	Changed

			<p>(underline added):                  This proposed SQMS requires that, at least annually, the individuals assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluate the system of quality management and concludes whether the system of quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph 15a–b, are being achieved.</p> <p>The equivalent paragraph 9 in International Standard on Quality Management (ISQM) No. 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements, uses “individual(s).” We suggest that the Auditing Standards Board (ASB) add “individual or” in front of “individuals” in paragraph 10 to indicate that this role can be fulfilled by a single person or multiple people, depending on the complexity and size of the specific audit organization. In addition, “evaluate” and “concludes” are plural and singular verbs, respectively, whereas the ISQM No. 1 uses a singular verb in both cases.</p>	
10	143	10	<p>D&amp;T does not believe that it is appropriate to diverge from the International QM standards and only use the plural form of “individual” throughout the proposed QM standards, as the plural form implies that there should be more than one person assigned ultimate responsibility and accountability for the firm’s SOQM, and similarly that there should be more than one person assigned operational responsibility for the firm’s SOQM. Depending on the organizational structure of the firm, this may or may not be the case. By inferring that multiple individuals are needed to fill these roles, this change has scalability implications that are contrary to the overarching principles followed when developing proposed SQMS Nos. 1 and 2. D&amp;T recommends that all instances of the use of the word “individuals” be identified in proposed SQMS No. 1 and that the wording be aligned with the International QM standards (i.e., revert to a format (“individual(s)”) where such positions may be filled by one or more than one individual).</p>	Agree – changed to “individual or individuals”
11	075	10	<p>During the performance of peer reviews, we have encountered situations where non-A&amp;A partners view their firms quality control policies and procedures as not important and not applicable to them. This creates significant challenges to the appropriate design of and compliance with strong QC policies and procedures.</p> <p>Therefore, we strongly support placing the ultimate responsibility for QM with the managing partner/CEO or equivalent. We understand that some commenters believe it would be a challenge when the CEO is a tax partner, however in this case we think it is</p>	Supportive

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			even more important that ultimate responsibility rest with them so that all firm policies and procedures are supportive and consistent with A&A QM policies and procedures.	
12	078	10	10. This proposed SQMS requires that, at least annually, the individuals assigned ultimate responsibility and accountability for the system of quality management, on behalf of the firm, evaluate the system of quality management and <del>conclude</del> conclude whether the system of quality management provides the firm with reasonable assurance that the objectives of the system, stated in paragraph 15a–b, are being achieved. (Ref: par. A5)	Corrected
13	168	10	Role of managing partner to oversee quality –For firms where audit is not the predominant service area, it may not be practical for the Managing Partner to have “ultimate responsibility” for the firm’s quality control. There are many firms that have significant tax or other non-attest services, and as such, the managing partner may not have the requisite audit technical expertise to oversee firmwide audit quality initiatives. In these instances, the responsibility for managing quality for audits will revert (whether directly or indirectly) back to the audit partner in -charge, who may otherwise be an engagement or service partner. For these instances, it may be appropriate for the standards to enable someone other than the managing partner to act in this capacity. We believe the requirements work for large primarily audit firms, but for firms with smaller audit practices, the added responsibilities to the managing partner may not have any practical effect.	No change. Peer review always interviews managing partner.
14	040	17	<p>We suggest the following items to SQMS No. 1 Definitions in paragraph 17:</p> <ul style="list-style-type: none"> <li>• Include the full definition of “network” as defined in the AICPA Code of Professional Conduct.</li> <li>• Define the term “remediation.”</li> <li>• Provide further clarity as to the meaning “external oversight authority” as used in the definition of external inspections.</li> <li>• Define “inspections.” There are several references to inspections in the requirements and application guidance. However, it is our view that inspections should be defined in the definition section to enhance the clarity and ability of the auditor to implement the standard. We suggest the following definition, based on GAGAS paragraph 5.54: Inspection. Inspection is a retrospective evaluation of the adequacy of the firm’s quality management policies and procedures, its personnel’s understanding of those policies and procedures, and the extent of the firm’s compliance with them.</li> </ul>	<ul style="list-style-type: none"> <li>• In extant, no change.</li> <li>• Disagree, plain English</li> <li>• Add examples – Peer Review, DOL... in Par A15</li>   <li>• Agree, in extant</li> </ul>

15	078	17	<p>17. For purposes of the SQMSs, the following terms have the meanings attributed as follows:</p> <p>...Deficiency in the firm’s system of quality management (referred to as deficiency in this proposed SQMS). This exists when (Ref: par. A10 and A169–A170)</p> <p>a quality objective required to achieve the objective of the system of quality management is not established;</p> <p>a quality risk, or combination of quality risks, is not identified or properly assessed; (Ref: par. A11)</p> <p>a response, or combination of responses, does not reduce to an acceptably low level the likelihood of a related quality risk occurring because the responses are not properly designed, implemented, or operating effectively; or</p> <p><del>an other</del> <b>another</b> aspect of the system of quality management is absent, or not properly designed, implemented, or operating effectively, such that a requirement of this proposed SQMS has not been addressed. (Ref: par. A12–A13)...</p>	<p>Changed to be consistent with American English usage.</p>
16	103	17	<p>Definitions</p> <p>The definitions provided in proposed SQMS No. 1 provide an appropriate base for practitioners to begin to establish a sound quality management system. There are a few areas where we believe more guidance would enhance consistency and effective adoption.</p> <p>Under this principles-based model, firms are to define their own quality objectives. The directive and application material included in proposed SQMS No. 1 appear to us as somewhat vague. Additional guidance would improve consistency in the objectives set by each firm.</p> <p>Using a risk assessment model in any risk assessment process is highly subjective, especially given the variability of quality risks among firms and the monitoring of those risks. We believe small firms will find the assessment of quality risk to be the most difficult aspect of the implementation of proposed SQMS No. 1.</p> <p>Without establishing more specific quality objectives in the areas of identification of quality risk, addressing those risks, and monitoring and remediation, significant variability can arise between how firms self-monitor on an annual basis and how peer review will identify a deficiency in a firm’s system of quality management.</p> <p>Changing the terminology from engagement quality control review (EQCR) to engagement quality review (EQR), for the sake of convergence, could be confusing and misleading. Under PCAOB standards the engagement quality review is generally more extensive than an engagement quality control review under extant QC section 10. Small</p>	<p>Noted</p>

			<p>and mid-size firms tend to have a Quality Control or Quality Assurance department or process where they determine the level of review needed on an engagement. In many cases, an independent pre- issuance review of an engagement is performed, not an EQCR, for a variety of reasons including, but not limited to, risk assessment and resource constraints within a firm.</p>	
17	134	17	<ul style="list-style-type: none"> <li>• Engagement team’ We are concerned with the proposed definition of “engagement team.” It is our understanding that the proposed definition of engagement team would include component auditors, which we believe could lead to a variety of operational challenges when applying certain requirements. In particular, we are concerned with the clarity of the requirements, as well as how such requirements would be applied, related to intellectual and technological resources in the context of component auditors some of whom are both engagement team members and service providers. Likewise, we are concerned with the appropriate application of quality management at the engagement level and the extent of the engagement partner’s responsibilities, such as taking responsibility for consultations being undertaken by component auditors and determining that sufficient and appropriate resources are made available to component auditors. While we appreciate some of the additional application guidance that has been added beyond international standards, the requirements themselves are not clear on their own. We understand that the IAASB intends to address the various concerns raised regarding the application of the proposed quality management requirements to component auditors as part of its group audits project. As a result, we encourage ASB members to consider whether waiting for the IAASB to make further progress on its group audits project might help clarify how to apply the proposed quality management standards and requirements at the engagement level. We note, however, that international standards do not allow engagement teams to make reference to a component auditor in the auditor’s report. Accordingly, we believe the ASB needs to decide whether component auditors, when the group auditor makes reference, are in fact members of the engagement team and, based on that conclusion, determine whether additional guidance is necessary. We further believe it is vital that the AICPA’s Professional Ethics Executive Committee (PEEC) deliberate, conclude, and provide guidance on the related independence ramifications of including component auditors as members of the</li> </ul>	<ul style="list-style-type: none"> <li>• ASB considering as part of Group Audit project and will amend QM standards thru that project if necessary.</li> </ul>

			<p>engagement team prior to adopting the proposed definition. We do not believe that the independence requirements apply equally to firms and engagement team members who are component auditors.</p> <p>In addition, an incorrect interpretation of what constitutes a “procedure” in this definition could result in diversity in practice and the misapplication of the proposed requirements, such that additional guidance may be warranted. For example, which aspects of an external confirmation constitute the procedure? Absent further clarity of these issues, we believe the proposed definition may have unintended consequences on who is considered a member of the engagement team as well as on the procedures that are required for those individuals. This includes situations that are described in the group audits standard where an auditor may use the work of another auditor (other auditor) that is not a component auditor.</p> <ul style="list-style-type: none"> <li>• ‘Auditor’ To address potential unintended legal consequences arising from network firms and other firms comprising an engagement team under the proposed definition, we suggest that the Board consult with legal counsel as to the proposed change in the definition of engagement team as well as whether there is a need to modify the definition of an “auditor” in the Glossary of Terms in US GAAS. As currently defined, the term “auditor” includes members of the engagement team. With the proposed definition of engagement team, the Board would include component auditors (or other auditors) within the firm’s network and other firms in the proposed definition of auditor. However, references to an “auditor” throughout generally accepted auditing standards (GAAS) have been made historically in the context of the firm and the related engagement team issuing the auditor’s report. Therefore, it might be inappropriate to imply that references to “auditor” throughout GAAS now also include component auditors (or other auditors), as this interpretation could considerably blur the lines of responsibility. In this regard, the definition of “auditor” could be enhanced or clarified to refer to or acknowledge the auditor of the group financial statements.</li> <li>• ‘Deficiency’ We also have concerns about the proposed definition of “deficiency in the firm’s system of quality management” (deficiency) and how this term is intended to interact with the definition of “deficiency” as it appears in paragraph 70b of Standards for Performing &amp; Reporting on Peer Reviews (PRS). The inconsistency</li> </ul>	<ul style="list-style-type: none"> <li>• Group Audit TF will be asked to consider</li>   <li>• Group Audit TF to address</li>   <li>• Agree; see par. A167A</li> </ul>
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			<p>in definitions could lead firms to draw different conclusions in evaluating their systems of quality management and in peer reviewers’ evaluation of such systems. We believe this is a matter to be further discussed with the Peer Review Board (PRB), and we encourage the AICPA to develop guidance for firms and peer reviewers to enhance the understandability and consistency of the terms used. This may further include understanding the PRB’s plans, if any, to revise the PRS and collaborating on key definitions or requirements.</p> <p>We note that some of our comments concern differences that specifically relate to our jurisdiction. In this regard, we continue to encourage the Board to consider differences in our jurisdiction as part of their convergence and harmonization efforts with international standards.</p>	
18	143	17	<ul style="list-style-type: none"> <li>• Accounting and auditing practice – D&amp;T believes that the definition of “accounting and auditing practice” would be improved by referencing the professional standards that are applicable when performing the relevant audit and assurance engagements that are addressed by the proposed QM standards. Given that “professional standards” is also a defined term, it is not necessary to repeat those bodies designated by the AICPA Counsel as having standard-setting authority.</li> </ul> <p>In addition, D&amp;T has proposed edits by leveraging words in the definition of “professional services” from the AICPA code. As drafted, the definition of “accounting and auditing practice” is audit-focused and does not reflect all aspects of the accounting practice.</p> <p>Further, D&amp;T recommends that the last sentence of the definition be included as application material, as it is not pertinent to the definition itself.</p> <p>Therefore, the following amendments are proposed to paragraph 17 of proposed SQMS No. 1, as well as corresponding changes throughout the proposed QM standards:</p> <p><i>Accounting and auditing practice.</i> A practice <b><u>of the firm where the professional services are performed by engagement teams requiring accountancy or related skills. For purposes of the proposed SQMS, professional services are those engagements conducted in accordance with the following suites of professional standards:</u></b></p> <ul style="list-style-type: none"> <li>○ <b><u>Statements on Auditing Standards (SAS).</u></b></li> <li>○ <b><u>Statements on Standards for Attestation Engagements (SSAE).</u></b></li> <li>○ <b><u>Statements on Standards for Accounting and Review Services (SSARS).</u></b></li> </ul>	<ul style="list-style-type: none"> <li>• Accounting and auditing practice - Agree with mentioning standards; see proposed revisions to par. A9A.</li> </ul>

			<p>that performs engagements covered by this section, which are audit, attestation, review, compilation, and any other services for which standards have been promulgated by the AICPA Auditing Standards Board (ASB) or the AICPA Accounting and Review Services Committee under the “General Standards Rule” (ET sec. 1.300.001)† or the “Compliance With Standards Rule” (ET sec. 1.310.001) of the AICPA Code of Professional Conduct. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice. <b><u>(Ref: par. Axx)</u></b></p> <p><b><u>Axx. Although standards for other engagements may be promulgated by other AICPA technical committees, engagements conducted in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.</u></b></p> <ul style="list-style-type: none"> <li>• Network – D&amp;T believes that consideration should be given to including the entire definition of “network” from the AICPA code, but at a minimum, the definition should reference “firms” as it will provide better linkage to the companion definition of “network firm.” D&amp;T recommends the following edits: Network. An association of entities <b><i>that includes one or more firms</i></b>, as defined in “Definitions” in the AICPA Code of Professional Conduct (ET section 0.400).</li> <li>• Network Firm – Although D&amp;T agrees with the clarification in the last sentence of the definition of “network firm,” we believe this is best placed in application material. Further, the manner in which the sentence is drafted may lead an individual referencing the proposed QM standards to substitute the phrase “network firm” with the phrase “as another firm or entity that belongs to the same network as the firm” throughout the proposed QM standards. There are, however, instances where the phrase cannot be readily substituted into an existing paragraph — for example, paragraph A21 of proposed SQMS No. 1. D&amp;T recommends the last sentence be redrafted as follows and included as application material: Network firm. A firm or other entity that belongs to a network, as defined in</li> </ul>	<ul style="list-style-type: none"> <li>• Network - Agree with proposed change</li> <li>• Network Firm - Disagree that the phrase can't be substituted in par. A21. Unsure of the ramifications of using “intended to mean” instead of “read as”. No change.</li> </ul>
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			<p>“Definitions” in the AICPA Code of Professional Conduct (ET section 0.400). <del>References to a network firm are to be read hereafter as “another firm or entity that belongs to the same network as the firm.” (Ref: par. Axx)</del></p> <p><u>Axx. Throughout the proposed SQMS, references to a network firm are intended to mean to be read hereafter as “another firm or entity that belongs to the same network as the firm.”</u></p> <ul style="list-style-type: none"> <li>Partner – D&amp;T believes that the penultimate sentence of the definition of “partner” is intended to encompass persons that are “partner equivalents” as defined by the AICPA code. We therefore recommend amending the sentence to reflect the AICPA code.</li> </ul> <p>Further, similar to other defined terms that are common to both proposed SQMS No. 1 and the AICPA code, there should be a reference to the applicable section in the AICPA code; otherwise, there will be confusion when considering this defined term in relation to the AICPA code. We propose the following edits:  <i>Partner.</i> Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner <b>encompasses both partner and partner equivalent as defined in “Definitions” in the AICPA Code of Professional Conduct (ET section 0.400)</b> <del>may include an employee with this authority who has not assumed the risks and benefits of ownership.</del> Firms might use different titles to refer to individuals with this authority.</p>	<ul style="list-style-type: none"> <li>Partner- No change; in extant. Definition of <i>partner equivalent</i> states it is solely for the purpose of applying the “Independence Rule”</li> </ul>
19	143	17	Engagement partner – The footnote “Engagement partner, partner, and firm refer to their governmental equivalents when relevant” included in proposed QM SAS was inadvertently omitted from the definition of “engagement partner” in proposed SQMS No. 1. We recommend reinserting it.	No change; not applicable to SQMS1. Consistent with extant.
20	143	17	We believe that the types of engagements managed by the firm’s system of quality management (SOQM) could be more clearly articulated by referring to the professional standards that they are conducted in accordance with, instead of referring to the names of the services performed. D&T understands the need to use the phrase “accounting and auditing practice” throughout the proposed QM standards instead of continually listing all the engagements addressed; however, there may be confusion when referencing certain engagements without providing the necessary context. For example, a reference to “review engagements” may refer to “review engagements conducted in accordance with the Statements on Standards for Attestation Engagements” or “review engagements conducted in accordance with the Statements on Standards for Accounting and Review	No change

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			Services.” Given the importance of having clearly defined parameters for the engagements to which the firm’s SOQM applies, we believe it is simplest to refer to the professional standards (refer Appendix I, response to question 1 for our recommended edits to the definition of “accounting and auditing practice”).	
21	156	17	<ul style="list-style-type: none"> <li>• “Response” vs “Response to quality risk” - Throughout the document the phrase commonly used is “response to quality risk.” We noted a few instances where “response” was used (e.g., A40, A41, A120). For clarity, it would help to use the phrase “response(s) to quality risk” throughout the document.</li> <li>• Throughout the document, there are indexed references (e.g., 17a, 17b, 17c) back to defined terms in paragraph 17. However, paragraph 17 is not referenced in such a manner, thus either the references throughout should be revised to reference paragraph 17 or the terms in paragraph 17 should be indexed</li> </ul>	<ul style="list-style-type: none"> <li>• “Response” is a defined term. “response to quality risk” is not used in the standard (phrase is, appropriately, “response to address quality risk”). No change.</li> <li>• Agree, changed.</li> </ul>
22	160	17	<p>The term “public interest,” or close variants, is used throughout the document. I suggest this term be defined in the document and that it should expressly include “client.” ET sections define and differentiate “the public” and “clients” depending on whether discussing the profession or individual members. Most practitioners reading this standard would likely interpret “public interest” to not include clients.</p> <p>Since most firms do not include a true “public” element, they may believe the standards do not apply in the respective cases where that term is used. I believe the standard should stress the importance of applying these standards to all engagements, and the public interest includes clients and colleagues, as Ethics would imply. It should not be left to cross-referencing standards or a separate reading of other standards.</p>	No change; all mentions of public interest appear to have context to them that explains the meaning and/or connections to the ethics standards.
23	026	24	<p>Good session but focus on peer system is separate problem, not root cause of discontent. I believe It is the current lack of information and examples that rile them up. I think the smaller firm is missing the concept of what a principal based system is. We actually envision with a more risk based principal approach we will save time and cut out some of the more mundane EQCR review clients. Currently our policy is all audits, reviews with a guide (i.e. non-profits or say construction) and any new compilation client require an EQCR. Reading the proposal, under a risk based approach we will evaluate the engagement partner, the client sophistication , the length and complexity of our relationship, and any industry issues and then decide if an extra set of eyes are needed. Also currently our policy requires the partner or technical reviewer to</p>	Noted

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			look at every workpaper. Under a principal based risk approach we will evaluate each client separately.	
24	047	24	NASBA agrees in concept with the risk-based approach in the proposed standards and believes the changes will improve audit quality and benefit the public interest.	Noted
25	061	24	SQMS No. 1 makes it clear that a firm should design and implement a risk assessment process to: 1) establish quality objectives, 2) identify and assess quality risks, and 3) design and implement responses to address quality risks. However, practical examples are not present in the guidance. For example, paragraph 25, A43, A44, and A45 address quality objectives but there are no practical examples of a quality objective. It seems the guidance should provide some examples of basic quality objectives, as well as quality risks, to provide firms a starting point for designing a risk assessment process under this new guidance. As written, the guidance is broad and passes the responsibility of establishing a “template” for a risk assessment process to the firms. In the case of small firms, the development of a risk assessment template will likely fall to service providers.	Par. 25 provides ALL the quality objectives. Implementation material will clarify and provide templates.
26	075	24	<p>While we appreciate that the proposed risk assessment process provides scalability to the QM standards, we are very concerned with the ability of smaller firms to perform an appropriate risk assessment. Our concern is not that we think it will be too difficult, but because we understand the lack of resources of smaller firms.</p> <p>Even in firms some would consider “larger”, firm partners are involved in client engagements and cannot afford the significant (non-billable) time it will take to implement these standards properly. In order to make the implementation possible for smaller firms, robust implementation guidance will be necessary. Such implementation guidance needs to include checklists and sample risk assessments/responses. The implementation guidance needs to be scaled to various size firms, from the smallest less complex practice up.</p> <p>Such implementation guidance, from the AICPA and/or third-party providers should be available with sufficient lead time before the effective date. Whether that means moving the effective date out (with early implementation allowed) or having tiered implementation dates is not as important as having the necessary resources in hand with sufficient time to implement effectively.</p>	Noted

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27	077	24	The risk assessment process, as described, provides a scalable and organized approach to establish a firm’s quality objectives, identify and assess risks to the achievement of the quality objectives, and design and implement responses to address the quality risks.	Noted
28	089	24	The committees believe that similar to audits, there should be some presumed risks identified that apply to all firms. Two examples of such risks discussed by the committees as examples to consider include: the risk of override of controls, and the risk of the incapacity of key persons in the system of quality control (including the managing partner, quality control partner, and engagement partner.) Both are frequent reasons for findings of non- conforming engagements in peer review.	Noted for implementation material
29	092	24	In general, we believe the application material is helpful. Additional clarifications, illustrations, or practice aids in the following areas would also be helpful:  The Firm’s Risk Assessment Process Illustrations of a risk assessment for a more complex firm. Guidance on the expected extent of documentation.  Guidance regarding conditions, events, circumstances, actions, or inactions, if any, that should presumptively be assessed at high for quality risks	Noted
30	094	24	Proposed SQMS No. 1: Requiring and implementing a risk assessment process, prohibiting self- inspection and requiring a cooling off period are our primary concerns within this proposed standard for sole practitioners and small firms. Creating a risk assessment for quality management system with a customized quality management plan is both burdensome and costly for many smaller CPA firms and sole practitioner members and may not result in improved quality of audits. Additionally, assessing the system every two years in addition to the three-year cycle for peer review adds costs and raises the need for the peer review program to be aligned.	Noted
31	100 TIC	24	As noted previously, TIC is supportive of the Board including a risk assessment process within the proposed standards. While we do not have any significant concerns with the risk assessment approach, TIC is concerned there may be diversity in practice when applying this guidance. For example, some firms may identify quality risks at a very high level and others may take a very granular approach. This, in turn, would have an affect on the risk response and ongoing monitoring requirements. To address this concern, TIC encourages the development of a practice aid which includes examples that provide: A brief overview of the type of firm and their operating environment The quality objective being illustrated, with references to the specific paragraphs of the	Noted

			<p>standard</p> <p>Examples of quality risks which may be identified by the firm related to that objective</p> <p>Example of responses to the identified risks</p>	
32	100 TIC	24	<p>TIC appreciates the Board applying a risk-based approach to identify and respond to quality risks, because that approach corresponds with how engagements are performed, which results in harmony between the approaches. However, TIC suggests the Board consider the following revisions to several aspects of the proposed SQMS.</p>	Noted
33	102	24	<p>The proposed SQMS No. 1 sets forth 8 components for a firm's quality management systems.</p> <p>The first component is a risk assessment which requires a firm to perform a tailored risk assessment of its quality risks, considering the firm's nature and circumstance, the firm's engagements to be performed and the barriers to which the firm's specific operations could adversely affect the achievement of the firm's quality objectives. For each quality risk identified, the firm will be required to design and implement a response.</p> <p>Under Paragraph A48 examples of the firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and related examples of quality risks that may arise are set forth. To paraphrase one example under this paragraph:                      Example of the Firm's Understanding - The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.                      Example of Quality Risks that Might Arise - In the context of governance and leadership, this may give rise to a number of quality risks such as that Leadership's responsibilities and accountability for quality are not clearly defined and assigned and that the actions and behaviors of leadership that do not promote quality are not questioned.</p> <p>Members believe this leadership process will not be instinctive and that small and medium sized firms will find the process hard to implement. This will result in quality management failures.</p> <p>Paragraph A49 provides an additional example of how complex this process could be. Specifically, it explains that responses to quality risks could cause additional quality risks. Members see these additional risks after assessment of the first risks as evidence that</p>	Noted

		<p>this process could be overly complicated.</p> <p>The risk assessment process will need to be ongoing. Firms will need to be aware of potential changes to its quality risks at all time including in the middle of performing engagements. This will be</p> <p>Members further are concerned with how to define systematic causes in order to properly assess and design procedures to overcome any systematic deficiency.</p> <p>Finally members are concerned about how to properly define "risk assessment" and how to document the risk assessment process properly. The documentation process could be viewed as overly complex. Improper documentation will result in quality management failures.</p> <p>Smaller firms monitor their risks in a very different way than larger firms. A smaller firm when assessing engagement level risks during the course of the engagement will address the risk, but not professionally document this. With the peer review mantra of "If it isn't documented it wasn't done" this is akin to "set up to fail" for these firms.</p> <p>Implementation of risk assessment procedures in audits has taken more than a decade including a 3 year "bye" period. Firms will need more than the allotted time for the proper implementation of applying risk assessment to themselves. Many of the difficulties firms confronted in applying the audit procedures will be encountered internally</p>	
34	103	<p>24</p> <p>As noted above, the risk assessment process is highly subjective, which will inevitably result in significant diversity in application, process and results. The diagram on page 10 of proposed SQMS No. 1 provides a good graphic depiction of what a risk assessment process needs to include, but more guidance would prove beneficial to fully execute this process.</p> <p>For consistency and effectiveness, further information on what the risk assessment process should look like and how that process should be documented is needed. We recommend an outlined framework to assist in assessing quality risk objectives, providing a scale (low, medium, high, for example) which would incorporate the factors influencing the auditor’s professional judgment, and a methodology for monitoring at the conclusion of the engagement.</p>	Noted

			<p>Small firms face greater challenges in accomplishing a robust risk assessment process due to their limited resources to develop their own quality management system. These firms could become overly reliant on their third-party providers for sample models.</p> <p>Past peer reviews and other regulator inspections reported that auditors struggle with assessing risks in an audit of financial statements appropriately. Firm objectivity on its own risk assessment will likely be more challenging than the risk assessment performed for an engagement. Without more definitive and clear guidance, we believe firms may not adopt the standards effectively and be set up to fail external monitoring.</p> <p>Quality may be lacking because of poor or uninformed judgment when it comes to risk assessment. A framework that can be reasonably and consistently applied in combination with professional judgment may be necessary for an effective result.</p>	
35	109	24	<p>The Committee supports using a risk assessment process to help customize how firms approach their quality management system. Each firm faces unique challenges based on size, client base, and geographic location. Small firms that serve only nonpublic, nonissuer clients will have a much more simplistic framework than a larger firm that serves public and issuer clients. This problem holds true for niche firms that only serve clients in a specific industry.</p> <p>As auditors, we currently use a risk-based auditing approach to help tailor our audit procedures to the areas most at risk to create a material misstatement on the financials. If we follow this same concept, many firms should reduce the amount of work needed to design and maintain their quality management system (in theory). The Committee's main concern with implementing these new standards is the same issue we faced in developing a risk-based approach to our audits. That concern is related to over- or under-designing the framework of the quality management system. Auditors struggle with how much auditing is too much auditing vs. "have they addressed all risks." Without proper guidance, many firms will try to think of every possibility without determining the quality of the risk. This fear comes from the worry that the firm's peer reviewer will second guess their judgment, resulting in comments or a non-clean peer review report.</p> <p>Peer reviewer training will be crucial to the success of this project. If peer reviewers have the authority to second guess the judgment of the quality management team, the purpose of this proposed change will be lost. Firms will perform a "kitchen-sink" approach vs. a risk-based approach. The program will be more successful if peer reviewers are focused on the process taken and the documentation to support the identified quality risks and corresponding responses.</p>	Noted

			<p>The Committee feels the iterative risk assessment process should emphasize that updating the firm's quality management system should not be overly burdensome while always being aware of new risks or changes to quality risk. If it becomes too onerous to maintain, firms will avoid the process. The guidance should emphasize that as deficiencies are noted through internal or external sources (inspections, changes in IT, etc.), consideration should be given to the need to update a firm's quality management system during the annual update. Of course, if a new quality risk is significant, immediate changes may be required, but those will take time to implement.</p>	
36	110	24	<p>We believe the risk assessment process is a positive change and will result in a more comprehensive quality management system. However, we are concerned that some firms will have a challenge implementing the risk assessment process and we request the ASB to provide additional clarity and examples within the final standard or supplemental practice aids to assist firms of all sizes in applying those requirements.</p>	Noted
37	119	24	<p>The proposed SQMS No. 1 would require a firm to perform a tailored risk assessment of its quality risks, taking into consideration the nature and circumstance of the firm, the engagements performed, and the degree to which these firm-specific factors could adversely affect the achievement of the firm's quality objectives. For each quality risk identified, the firm is required to design and implement a response.</p> <p>Paragraph A48 provides examples of the firm's understanding of the conditions, events, circumstances, actions, or inactions that may adversely affect the achievement of the quality objectives and related examples of quality risks that may arise. One such example includes the following:</p> <p>The characteristics and management style of leadership: The firm is a smaller firm with a few engagement partners with shared authority.</p> <p>In the context of governance and leadership, this may give rise to a number of quality risks such as the following:</p> <p>Leadership's responsibilities and accountability for quality are not clearly defined and assigned.</p> <p>The actions and behaviors of leadership that do not promote quality are not questioned. We do not find this process to be intuitive and believe that many firms will struggle with the process, resulting in many quality management failures. More importantly, we do not believe that this will result in improved audit quality.</p> <p>Paragraph A49 provides an additional example of how complex this process could be. Specifically, it explains that responses to quality risks could cause additional quality risks.</p>	Opposition to risk-based process noted

		<p>Given the evolving nature of the system of quality management, the responses designed and implemented by the firm may give rise to conditions, events, circumstances, actions, or inactions that result in further quality risks. For example, the firm may implement a resource (for example, a technological resource) to address a quality risk, and quality risks may arise from the use of such resource.</p> <p>We view these additional risks as evidence that this process could be overly complicated. Furthermore, as the risk assessment process is to be iterative, the firm needs to continuously be aware of any potential changes to quality risks. This is particularly onerous for small firms with limited accounting and auditing practices. Larger firms may have teams of quality management professionals that are dedicated to the implementation of this new approach, but smaller firms like ours cannot afford the additional cost of continually reconsidering whether they have identified all appropriate quality risks.</p> <ul style="list-style-type: none"> <li>• Consider a firm that performs only Statement on Standards for Accounting and Review (SSARS) engagements or a firm that performs a handful of attest engagements. How much time and training would it take to implement this new approach? Outside expertise may be needed as firms only performing SSARS may not be familiar with the risk assessment process, and peer reviewers would not be able to assist with quality management system design due to independence constraints.</li> <li>• Consider a small firm of two partners, with five professionals total, where all attest engagements are performed by one partner. The new standard requires the managing partner to have ultimate responsibility and accountability for the system of quality management. Under the current standards, the managing partner can rely on the annual monitoring report and peer review to determine the adequacy of the firm's quality control system. How will this firm be able to maintain a fluid quality management system? How much time and effort will the managing partner need to spend to ensure that the system is updated every time risks are changed? How much training will this entail? This effort is difficult to conceptualize.</li> </ul> <p>We have noted in connection with peer review results that many practitioners struggle with risk assessment and linking assessed risks to appropriately tailored responses, leading to overreliance on and improper use of practice aids. We believe that this proposed risk-based approach to tailoring a firm's quality management system will be difficult and costly for many firms to implement.</p>	
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			If the risk-based approach is retained, we recommend extensive practice aids for varying sizes of firms and templates that firms can tailor with dropdown menus providing examples of quality risks and sample responses.	
38	125	24	We note that one of the two new elements The firm’s risk assessment process states that this is a new approach that focuses the firms’ attention to risks that may have an impact on engagement quality. I would disagree that this is new, but rather inherent in the firm’s current system of quality control. When a firm has developed its existing system of quality control, the policies and procedures included in that system are directly in relation to risks. Although inherent in the existing systems, it is most apparent in the firms’ Engagement Quality Control Policy in which the firm’s, through an evaluation of the make-up of their client base, specifically identify the types of engagements that present heightened risks and therefore require the firm to subject those engagements to additional review procedures.	Noted
39	132	24	While risk assessment is core to the effective audit, a continuing and perpetual reconsidering of re-assessing all aspect of impact or potential impact/influence of risk and how that might revise the audit team actions seems incredibly complicated and burdensome that will be difficult to implement and apply, and which will likely overly emphasize focus on administrative monitoring and documentation of ongoing assessment rather than the actual performance of the audit. Further, the overall inferences of the proposed standard is that, as a part of the quality management system, such risk assessments should be applied to non-audit engagements as well, such as reviews and compilations, which far exceed the statement goals and responsibilities of these engagements, and would appear to greatly expand the liability threats to the CPA practitioner providing a non-verification (non0-audit) engagement.	Noted
40	134	24	Risk assessment process As our firm continues to work on the implementation of the international quality management standards, we have encountered some challenges with the risk assessment component. We believe the profession would greatly benefit from robust implementation guidance to assist practitioners in understanding the level of granularity that is expected in the documentation of this component. This guidance could include examples of how risk assessment may differ, regardless of the size of the firm. We believe this guidance could also assist with the risk of inconsistent application as well as our concern expressed above. Application guidance would also be helpful in the area of documentation and,	Noted

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			particularly, the nature and extent of documentation of the firm’s rationale for the level at which the firm assessed its quality risks.	
41	135	24	<p>However, the requirements of SQMS No. 1 regarding the new component of risk assessment appear to be conceptual and not fully inclusive of clear guidance for successful implementation by firms.</p> <p>The proposed standard requires the firm to establish specific quality objectives for each component except monitoring and remediation. The firm is required to establish additional quality objectives when necessary to achieve the objective of the system of quality management; however, based on the nature and circumstances of the firm and its engagements, the firm may not find it necessary to establish additional quality objectives.</p> <p>Requiring “specific” quality objectives while stating the firms can apply professional judgement appears contradictory in nature and not a design for successful implementation. Additional guidance will be needed for firms to properly identify the specific quality objectives and additional quality objectives that will comprehensively address the requirements of the proposed standard.</p> <p>The same can be said for the risks to the achievement of the specific quality objectives and quality risks. Additional guidance will be needed for firms to properly assess the risks to the achievement of the identified specific quality objectives and additional quality objectives that will comprehensively address the requirements of the proposed standard. Other components of the Quality Management Standards will not feel as foreign to firms as 6 of the remaining 7 components are already rooted in QC Section 10.</p>	Noted
42	136	24	<p>Getting back to the risk-based approach to quality management (as you have included in the QB document), wouldn't it make sense that if a risk is identified, such as a new "complex" accounting standard has been implemented or a "new industry" client for the firm that this would be the circumstance for a small firm to obtain an outside engagement quality review. This risk as identified by the firm should then be a Peer Review inspection item to ensure that this is in fact the practice of the firm. If the firm is found by its Peer Reviewer to not comply or have performed a questionable engagement quality review, then that firm should be required to outsource its EQR for the next two years. If, in the judgment of the Peer Reviewer, the firm has complied then the firm may continue to use the risk-based assessment noted above.</p>	Agree, for implementation guidance

Regarding internal inspections, rather than outsourcing this process under all circumstances, We recommend that the if a risk has been identified that those engagement(s) internal inspection be outsourced. However, if a risk has not been assessed, we recommend that a cooling off period from the date of the financial report is adequate for a Partner to later inspect that engagement.

Also, the practice of outsourcing the engagement quality review and internal inspections is sure to hit roadblocks as the number of available practicing and qualified CPAs continues to decline. (The Illinois CPA Society has a 2021 Special Feature dedicated to "Decoding the Decline" in the CPA credential.) Who will perform these reviews if there are not available reviewers? This will impact the audited client. This will affect the audited organization in a financial way, e.g., from funder or financial institution requirements and timeliness of available audited financial reports.

Development of the SQMS

In the development of the Standards, have the committees considered the following:

How much latitude will firms have when determining quality risks?

Are there specific examples that always or in most cases pose a quality risk?

Are there examples or recommendations for the conditions, events, circumstances, actions, or inactions that create a quality risk?

Since the proposed language states "The assessment of quality risks does not require formal ratings or scores", is it appropriate to use low, moderate, and high or a score of 1 to 10 as appropriate ranges for risk? Without an end-result in mind for scoring and/or ranking risks, how will a firm determine, understand, and respond appropriately to the severity of the risks?

Will the firm be subject to the redetermination of the risk levels by the firm's peer reviewer? How does the firm's risk levels impact the peer reviewer's risk assessment process?

What if the peer reviewer determines the risks to be more severe than the peer reviewed firm?

When assessing the degree to which the factors may adversely affect the achievement of the quality objectives, are there examples that will assist firms in determining if a risk is low, moderate, or high?

Risk assessment is a complex process where mitigating procedures to eliminate risks

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			could create other risks. Guidance needs to be established regarding when a firm should stop identifying risks. For example, if the firm uses an outside reviewer to mitigate the self-review threat, there is now a risk that the outside reviewer doesn't identify all key findings during his/her review because the outside reviewer may or may not have been qualified. How should firms prevent being caught in a circular risk assessment process?	
43	138	24	Regarding the risk assessment component, additional guidance on the approach and documentation requirements should be provided to ensure a consistent approach across firms.	Noted
44	139	24	Risk Assessment Process Developing and documenting the risk assessment process for smaller firms will be costly and will require implementation guidance. Firms who currently do not perform audits may be unfamiliar with the risk assessment process and therefore may struggle to develop the risks associated with their practices and the responses thereto. In addition, small firms who do not have teams of quality management professionals will find it difficult and costly to continually reconsider whether all risks have been identified, documented and appropriate responses developed.	Noted
45	142	24	Furthermore, we support the proposed requirements for evaluating findings and identifying deficiencies, and evaluating the severity and persuasiveness of the deficiencies, including investigating the root cause of identified deficiencies. However, there is potential risk that without sufficient application guidance, firms may not apply such analyses consistently, which could result in varying results that may not be in the spirit of the requirement. We believe a consistently applied root cause process can provide insight into potential systemic issues of identified deficiencies and assist firms in developing remedial actions that are directly responsive to such issues and highlight opportunities to enhance the firm's system of quality management.  A consistently applied root cause analysis could also provide the ASB insights into potential areas of profession-wide improvements. This information could help drive future standard setting projects and related guidance activities, such as developing indicators of audit quality that could provide additional insights on factors that may contribute to or detract from audit quality.	Noted
46	145	24	We are of the opinion the new risk assessment standard in this proposed exposure draft is already being addressed in the next round of Audit Quality Initiatives by the AICPA. Since the typical composition of the engagement teams of our membership are already being addressed, the proposed changes would not be appropriate for our membership.	Noted

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			<p>However, for those firms that would be affected by this proposed SQMS, the application materials are helpful.</p> <p>Additionally, we are of the opinion the proposed changes would not be scalable for our membership because the added cost and burden of implementation and maintenance would result in placing our firms at a competitive disadvantage.</p>	
47	148	24	<p>However, identifying, assessing, and responding to quality risks in an effective, efficient manner may be a challenge for many firms unaccustomed to assessing firm structures and operations, especially for sole practitioners and smaller firms. The Society requests additional clarity and examples on several components of the risk assessment process and that additional guidance be provided for the proposed SQMS No. 1 before moving forward with implementation.</p>	Noted
48	149	24	<p>I was very disappointed to see that the proposed new quality management standards are incorporating a risk assessment process. I was very disappointed when the audit risk assessment standards were implemented several years ago as I don't believe they increased the quality of audit engagements but rather provided firms with a tool to not audit or review certain aspects of a clients trial balance based on a low level of assessed risk. I do realize that is a very simplified reference to the risk assessment standards but from my point of view the biggest result of the standards was an incredible amount of paperwork to fill out. Though there is of course some inherent benefit to utilizing a risk based approach, I learned the auditing profession by auditing all of the assets and liabilities on a clients trial balance rather than determining which areas should be audited and to what extent based on a self completed risk assessment. Your proposed quality management standards want to eliminate the self inspection aspect (which I will address separately) though the auditing individual or firm is able to self complete a risk assessment on what aspects of a client they feel need to be audited and to what extent. This assessment can be completed and documented in an effort to guide what you have to audit and what you don't want to audit simply by documenting the justifications for your assessment. As there is always a level of professional judgement involved in this process it would be difficult for any external review to realistically question the assessments made. Based on the way I learned the auditing professional I probably over audit a bit in order to make sure nothing is missed. I doubt that is the predominant philosophy.</p> <p>The three step risk assessment process seems like unnecessary additional steps to what should already be the expectation in completing an auditing engagement. The first step</p>	Noted

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			being the establishment of quality standards seems particularly unnecessary as the main objective of the auditing engagement should be to perform the audit in accordance with all of the applicable rules and regulations. If this is done it would seem as though the natural result would be a high quality engagement. I am perhaps over simplifying this aspect but it could also be argued that the new standards are over complicating this aspect.	
49	156	24	<p>New Approach Focused on Quality Management: The principles-based approach taken in SQMS No. 1, centered on the 8 components to quality, is theoretically sound. However, we are finding the practical application of the model very complicated as we develop our implementation approach. We have worked through some of our quality management processes with the proposed standard in mind and found some aspects of the model difficult to apply and document in a holistic manner. The integration of the various components of quality causes complexities. The process of identifying and assessing quality risks to achieving quality objectives often extends beyond a single component. Further, processes supporting quality management support various quality objectives. Thus, the linkages of control activities to quality objectives will be multifaceted. Using the Information and Communication Component as an example, there are risks pertaining to the quality objectives set forth in paragraph 34 of SQMS No. 1 which cascade into risks that pertain to other components. (e.g., information supporting judgments on whether to accept or continue a client relationship). Building a system that documents our risk assessment and related responses to demonstrate how our QM system achieves the requirements in SQMS No. 1 will be very challenging to develop and maintain. We agree with the principles-based approach but acknowledge and bring to your attention the intensive time and effort firms will have to undertake to properly implement the standard and maintain compliance going forward.</p>	Noted
50	160	24	<p>I believe the shift from a focus on the standalone elements of the extant standards to the new integrated and risk-based approach is a positive improvement.</p> <p>Having said that, the new standard appears to emphasize assessment of risk, i.e. what could go wrong and how bad would it be? I believe a more thorough description of how and why this is different from extant standards should be added or incorporated in the Application and Other Explanatory Material (AOEM). I believe extant standards provided for this to a large degree and I saw that was how many firms approached the standard and the design of their systems.</p>	Noted

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			<p>In conjunction with this, I also believe extant standards provided for scalability to a large degree, and third-party providers recognized that with the materials they developed. Paragraph .A1 of QC Section 10 implies that scalability is present in the extant standard “This section does not call for compliance with requirements that are not relevant (for example, in the circumstances of a sole practitioner with no staff).”</p> <p>How this proposed standard is different should be further emphasized if a different and improved result is desired.</p>	
51	161 PwC	24	<p>We support the principle of a quality management approach. In our view, this model is more reflective of how firms should be proactively managing quality, and more aligned to risk management frameworks used by other organizations.</p> <p>To achieve the transformational benefits of a more proactive approach to quality management, we believe it is important for a firm to take a top-down approach to assessing its specific risks to delivering audit quality. We support the framework set out in proposed SQMS No. 1 that would require the firm to establish quality objectives, which set the context for appropriately identifying and assessing the risks to achieving them.</p>	Noted
52	162	24	<p>Risk Assessment Process</p> <p>We believe a “risk based” approach is appropriate; however, we caution that without implementation guidance, the overall risk assessment process may be limited and not consistent with the overall risks that many firms face in today’s environment. Please see our response in Part 6, Question 9A, Development of Core Package for further discussion of ways we propose to aid in the implementation of the QM standards.</p>	Noted
53	166	24	<p>I like the risk assessment approach prescribed in the proposed SQMS No. 1, and appreciate that the standard addresses the importance of the firm’s operational and financial policies.</p>	Noted
54	167	24	<p>The addition of a firm risk assessment process appears appropriate.</p>	Noted
55	047	29	<p>NASBA recommends more clarity and discussion around firm governance, the responsibility for quality management within the firm other than the engagement partner and how firm quality management oversight should be exercised, for example, by specifically identifying the responsibilities, authority and separation of quality management oversight from engagement teams.</p>	This is specific to the nature and circumstances of the firm.
56	061	29	<p>This component is generally similar to the leadership responsibilities for quality within the firm (tone at the top) element of quality control in SQCS #8.</p>	Noted

			<p>Regarding understandability and clarity, it seems that there are too many references to follow to arrive at the guidance being sought. The guidance provided in the body of the proposed standard could include the information provided in the application material to make the guidance easier to follow. For example, paragraph 29.b. states that leadership is responsible and accountable for quality and then references paragraph A59. Paragraph A59 states that leadership is responsible for performance evaluations and then references paragraph 57. Paragraph 57 states that the firm should undertake performance evaluations and then references paragraphs A217-A219. Paragraph A218 indicates that a smaller firm may rely on the results of monitoring activities to provide an indication of the performance of an individual. It is not clear why it is necessary to present this information through a maze of references when it could be explained in a single paragraph. The concern that we have attempted to express here is perhaps articulated better in the Drafting Principles and Guidelines [DRAFT] prepared by the International Auditing and Assurance Standards Board’s Complexity, Understandability, Scalability and Proportionality (CUSP) Working Group, dated July 2021.</p>	<p>Agree but a clarity revision of the proposed standards is beyond the scope of this project. This feedback will be taken into consideration for drafting implementation guidance.</p>
57	077	29	<p>We agree with the inclusion of the Governance and Leadership component and the impact a firm’s leadership has on audit quality, including the system of quality management. A firm’s leadership is responsible for the overall direction of the firm and the success of its people, its clients, and its responsibilities to the public and the profession. The Governance and Leadership component outlines these areas and provides for ways to monitor involvement and execution.</p>	Noted
58	092	29	<p>Governance and Leadership Examples of organizational structures that demonstrate a commitment to quality.</p>	Noted
59	103	29	<p>We agree that quality begins with the tone at the top, where the leadership of a firm supports those with operational responsibility for the quality system and establishes governance that enables the partners and staff to understand how the culture, ethics, and monitoring impact the firm’s decisions. The substantial enhancements addressing governance and leadership provide improved, more specific guidelines to the managing partners, chief executives, and other leaders. Proposed SQMS No. 1 makes quality the responsibility of everyone in a firm, not just the Quality Control Department, while providing guidance on firm structure of responsibility. We do recommend the following:</p> <ul style="list-style-type: none"> <li>• Under extant QC section 10, paragraph .20, the “...person or persons assigned operational responsibility for the firm’s system of quality control by the firm’s leadership has sufficient and appropriate experience and ability, and the</li> </ul>	<ul style="list-style-type: none"> <li>• See par. 22</li> </ul>

			<p>necessary authority, to assume that responsibility.” We do not see the same emphasis on authority for those with operational responsibility in proposed SQMS No. 1. Furthermore, putting the monitoring responsibility with the chief executives, managing partners, or top leadership group (an executive committee for example) could lead to conflicts of interest depending on the extent of engagement responsibilities of those leaders. We recommend adding language emphasizing and clarifying the need for independent, objective, authority of those with operational responsibility for the quality management system and the need for independent monitoring of the quality management system. While small and mid- size firms may find this more challenging, they can consider a group of partners and staff, or a third-party who can monitor.</p> <ul style="list-style-type: none"> <li>Proposed SQMS No.1, paragraph 17, allows for policies to address quality risks that are “...implied through actions and decisions.” We recommend taking out this phrase and emphasizing that policies should be documented in the QM manual or another centralized receptacle, at least in all but the most unusual of circumstances (such as the beginning of the pandemic). Unwritten policies lead to inconsistency and confusion within a firm, resulting in a breakdown of quality, not an elevation of quality. We believe that if an action or decision is important enough, a policy can be written and disseminated appropriately throughout a firm in a timely manner.</li> </ul>	<ul style="list-style-type: none"> <li>No change; this would result in a less scalable standard</li> </ul>
60	104	29	<p>As a two CPA firm, the effect of the increased requirements on leadership and governance is nominal. Small firms like ours are adaptive instantly to change in our clients and any accounting or auditing issues that arise. There is no large hierarchy; each of us reviews the other’s work regularly which allows for timely corrections or enhancements.</p>	Noted
61	109	29	<p>The Committee supports the increased emphasis on governance and leadership (Par. 29) in the proposed quality management system. Having firms establish a "chain of command" while still emphasizing that the ultimate responsibility resides with the firm gives specific people ownership of the process, which usually leads to a better solution. The Committee's concern is small firms with limited staff having to maintain independence (Par. 29e). The current environment has put a tight ceiling on fees small firms can charge on assurance engagements. Adding costs to the process makes it more difficult for small firms to acquire talented staff and leadership. This potential loss of talent could have a more significant adverse effect on the quality of engagements than allowing an alternative for small firms to address the independence issue in Governance</p>	Noted

			<p>and Leadership.</p> <p>Having a focus on accountability through performance evaluations and other means, if properly designed, will allow the leadership of a firm's quality management system to provide the resources needed (their time) to maintain a well-designed system. People will perform based on the reward system; therefore, if a proper plan is not used to reward those responsible for the quality management, the focus on that area will fade away.</p>	
62	134	29	<p>Governance and leadership</p> <p>We generally support the revisions to the standard to address the responsibilities of firm leadership and do not have any recommended revisions to the proposed requirements.</p>	Noted
63	139	21	<p>Governance and Leadership</p> <p>SQMS No. 1 requires the assignment of ultimate responsibility and accountability for the system of quality management to the firm's managing partner or equivalent. In smaller firms it would not be unusual for the managing partner to be a tax practitioner. How will this individual be able to assess whether the system of quality management is appropriately designed and that proper responses have been established for all identified risks? How much training will be required for such an individual and how much reliance can this individual place on other personnel assigned to operational responsibility for the system of quality management or personnel assigned to specific aspects of the system of quality management?</p>	The managing partner can rely on audit partners to do this, but still is ultimately responsible for "tone at the top" and firm commitment to quality. Consistent with Peer Review. Implementation guidance will address how "ultimate responsibility" and "operational responsibility" relate.
64	146	21	<p>Role of Managing Partner</p> <p>For firms where the audit function is not the predominant practice area, it may not be practicable for the Managing Partner to have "ultimate responsibility" for the firm's quality control. Many firms in our state have significant tax or other non-attest services, and as such the managing partner may not be suited to have "ultimate responsibility" for the firm's quality control. In these instances, the responsibility of managing quality for audits would default to the audit partner in charge who most probably is also the audit engagement partner. For these instances, it may be appropriate for the standards to enable someone other than the managing partner to act in this capacity. We believe these requirements work for large, primarily audit firms, but for firms with smaller audit practices, the added responsibilities to the managing partner (who is or may be a tax partner) may not provide the desired effect.</p>	See par. A33; responsibility can be shared but managing partner is embodiment of firm. Peer review always interviews managing partner.

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65	162	29	<p>We agree overall with the proposed standard’s governance and leadership aspects. For the many firms that will be merging in the next 5 – 10 years and thus moving from a smaller environment to a larger one, the importance of appropriate governance and leadership and overall “tone at the top” will become more important for the Profession.</p>	Noted
66	010	30	<p>The section on Relevant Ethical Requirements refers to “applicable regulatory agencies.” Paragraph 1.400.050 of the AICPA Code of Conduct uses the terms “governmental bodies, commissions, or other regulatory agencies” with whose ethical requirements members are required to comply. The broader reference in the Proposed Standards could be interpreted to scope in additional entities and requirements. We suggest aligning the reference in the Proposed Standards with the definition in the AICPA Code of Conduct to avoid the risk of unintentionally expanding the scope of complying with the quality management standard to requirements of agencies that are not contemplated in the AICPA Code of Conduct.</p>	In extant, no change.
67	143	30	<p>Involvement of the AICPA’s Professional Ethics Executive Committee (PEEC)  Given the significant connection between the proposed QM standards and the AICPA Code of Conduct (the “AICPA code”), D&amp;T believes that it is imperative that PEEC review the wording used in the proposed QM standards, specifically those paragraphs that either (1) refer to the AICPA code, or (2) more broadly relate to relevant ethical requirements, including those that were revised from International QM standards to reflect the provisions of the AICPA code (i.e., instead of the International Code of Ethics for Professional Accountants).  We also recommend that, in addition to their current monitoring of the ASB’s activities relating to the proposed QM standards, PEEC undertake a project to review the AICPA code for the impact of changes resulting from proposed SQMS Nos. 1 and 2. Such a project will ensure that the AICPA code and the AICPA’s suite of professional standards remain aligned.  Further, in order to provide enhanced transparency across the various AICPA senior committees, we recommend that a representative from the ASB and PEEC, respectively, be present during pertinent discussions on topics of mutual interest when the corresponding senior committee deliberates. This collaboration will enable a more fulsome discussion of issues raised with real-time input from observers with the necessary expertise. Similarly, it will allow for more timely dissemination of information by the members to the respective senior committees for additional discussion and</p>	Such a review was performed in advance of the issuance of the exposure draft.

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			resolution as needed. This recommendation applies not only to the proposed QM standards but to all standards developed by AICPA senior committees.	
68	015	31	The beginning of the quality we have worked hard to secure starts with client acceptance. When someone comes to us outside what we consider our specialty, such as a request a few years back for us to be involved in a single audit engagement, we referred them to someone else. Just last week I told a potential client we do not perform work on public entities as it is outside our sphere of expertise. My point here is that we gladly accept ERISA and small business engagements in which we specialize, but we use firm judgement to stay out of the areas that could get us in trouble due to a lack of experience. So, we believe we know as much or more about the audit issues we are working to solve than an outside reviewer. Otherwise, we would not accept the engagement.	Noted
69	168	31	Client acceptance / continuance – The Committee feels that especially for smaller firms, a great deal of quality management arises from the initial acceptance / retention of clients. We would welcome more guidance and practice aids on integrating a firm-wide approach to client acceptance / continuance decisions.	Agree
70	040	32	<p>b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams. In addition, the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members <b><i>with an appropriate level of skill and proficiency.</i></b></p> <p>We suggest adding “with an appropriate level of skill and proficiency” to reflect our view that skill and proficiency as well as experience are essential for directing, supervising, and reviewing high-quality engagements.</p>	Agree – revised to say “suitably experienced” which is consistent with extant
71	143	32	<p>D&amp;T believes that the insertion of punctuation in paragraph 32b as compared to the International QM standards changes the context and intent of the requirement. We believe the nature, timing, and extent of direction and supervision of engagement teams and review of work performed is directly related to, and dependent on, the resources assigned or made available to the engagement teams. D&amp;T recommends that the wording revert and align with paragraph 31(b) of ISQM No. 1 as follows:</p> <p>32b. The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements. T and the resources assigned or made available to the engagement</p>	Agree - revised

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			teams;, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members.	
72	155	32	<p>Proposed SMQS No. 1 – we recommend consideration of changing the reference to “more experienced team members” to “appropriately qualified team members” as more experience alone may not be sufficient to provide appropriate direction and supervision depending upon the subject matter.</p> <p>Proposed SMQS No. 1 – we recommend that the definition of Personnel in paragraph .17 and/or the related application material in paragraph .A22 address whether this definition is intended to include auditor-employed or auditor-engaged specialists.</p> <p>Proposed SMQS No. 1 - paragraphs .A14- .A19 reference paragraphs .17g -.17j, however paragraph .17 does not include these letter references.</p> <p>Proposed SMQS No. 1 - paragraphs .A51, .A64, and the headings prior to paragraphs .A22, .A110 and .A159 all have similar subparagraph references to .17</p>	<ul style="list-style-type: none"> <li>• Agree, revised to be consistent with extant</li> <li>• See definition of “staff”.</li> <li>• Agree, corrected</li> </ul>
73	170	32	<p>We believe there is a typographical error in 32(b) and recommend the following edits: The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements- <del>and</del> the resources assigned or made available to the engagement teams;, and the work performed by less experienced engagement team members is directed, supervised, and reviewed by more experienced engagement team members. (Ref: par. A80–A81)</p>	Agree, corrected.
74	026	33	<p>I like the inclusion of the broadening of the QC concept to other areas than just A&amp;A and having focus on things like technology and Intellectual and HR areas. As an example of how it struck me and our firm, we have started to go over with the team what we need to improve on to make our system better. This includes a formalization of our HR evaluations, shoring up and make more formal our CPE review by individual, and thinking through better the individual team member growth mentoring. I think the smaller firm is seeing “big brother” coming instead of improvements.</p>	Noted
75	061	33	<p>This section was expanded to include technology resources and intellectual resources. We agree with the placement of technology and intellectual resources in this section. We noted that the standard does not seem to address “consultation” resources. We believe the standard should highlight the need of some firms to establish external consultation resources. For example, a firm should identify risks related knowledge and experience limitations within the firm when evaluating the need to use its external consultation resources.</p>	Noted

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76	077	33	<p>We agree with the inclusion of technological and intellectual resources within the Resources component as they are a vital part of a firm’s system of quality management and impact all engagements.</p>	Noted
77	092	33	<p>Resources Guidance on documenting that “appropriate intellectual resources” are available and used to enable the operation of the firm’s system of quality management and the consistent performance of quality engagements.</p> <p>Clarification of the degree to which firms need to document their evaluation of the appropriateness of technological resources that are used by engagement teams in performing engagements.</p>	Noted
78	109	33	<p>Resource availability is the section that causes the most concern to the Committee. Suppose we look at resources as two buckets. The first bucket is guidance provided by the ASB and the AICPA and the second bucket is workpapers and checklists created by PPC and other publishers. We see the first will be crucial for understanding with little to no costs outside of gaining knowledge, and the second will be essential for implementation with possibly significant costs.</p> <p>As noted above, smaller firms will incur the most significant hit to their bottom lines. In addition, they may lean too heavily on the resources provided by publishers and take the approach to answer every question and mark every checkbox to make sure they do not miss anything. This extra cost is both monetary and human. The desire to cover all bases will take considerable time, further pinching a firm's most valuable resource — time. Limited time means the first resource the ASB will need to provide is detailed guidance to help small firms feel comfortable doing less. As noted in Par. A29, smaller firms could exclude specific non-relevant requirements based on their facts and circumstances. Smaller firms would need help to ensure they do not include non- relevant areas and exclude relevant ones incorrectly.</p>	Noted
79	134	33	<p>Resources We generally support the proposed requirements related to the Resources component. Further, we appreciate the guidance provided by proposed paragraph A115, which we believe clarifies the interplay of the requirements for service providers who are component auditors.</p>	Noted
80	160	33	<p>I believe a critical element for most firms, other than the largest, are maintaining resources outside the firm. Many firms, particularly smaller firms, do not recognize their</p>	Noted

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			own limitations and have not appropriately addressed acquiring, assessing, maintaining or accessing such resources. This proposed standard appears to mostly address practice aids, technical literature access, and personnel used in engagement performance, but not “consultation” resources. I believe the standard should highlight the need for firms to develop external consultation (to use old verbiage) resources as needed and to specifically assess their needs in that area. Firms should identify where the risks are due to their knowledge and/or experience limitations. This should be an element more clearly and directly addressed under Resources in the main body of the standard, and elaborated on in the supplemental sections.	
81	162	33	We agree overall with the proposed standard’s resources aspect. As technology has improved and firms having expanded capabilities to serve non-attest functions, more is occurring at CPA firms. We believe the proposed standards will appropriately reinvigorate the focus of quality management on many aspects of firms.	Noted
82	170	33	We recommend revising 33(e) to make it consistent with the wording of the other requirements in paragraph 33 and to clarify the guidance as follows: <b>Individuals <u>are assigned to perform activities within the system of quality management</u> who have appropriate competence and capabilities, including sufficient time, to perform such activities <del>are assigned to perform activities within the system of quality management.</del></b>	No change, because it could cause confusion about whether there is a different meaning between GAAS / ISAs and the language as currently written is understandable.
83	077	34	We agree with the addition of the Information and Communication component and the importance for a continuous flow of information throughout the firm. As the first firm to define audit quality and a firm that publishes an annual audit quality report, we believe communication to the public and the relevant stakeholders is an important part of a system of quality management.	Noted
84	092	34	Information and Communication Additional examples of laws and regulations that would require a firm to communicate information to external parties.  Clarification of when communication to regulators may be required. Illustrations of how relevant and reliable information can be communicated externally to support external parties’ (such as investors) understanding of the system of quality management (e.g., what might be included in a transparency report, an audit quality report, or on a web page).	Noted

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85	092	34	In general, we believe the requirements in SQMS No. 1 are clear. However, we do question the level of effort necessary to comply with certain requirements and are concerned that it may be difficult to determine whether a requirement has been met. For example, the information and communication component requires that the firm recognize and reinforce the responsibility of personnel to exchange information with the firm and with one another. We believe it may be difficult for firms to demonstrate how they met this subjective requirement.	Open for consideration of how to document this – Address in implementation guidance
86	109	34	The Committee agrees with the emphasis on communication. Most failures are related to a lack of communication; therefore, making this a priority may help better identify quality risks and their pervasiveness within the system and better respond to pervasive quality risks. A well-maintained communication system combined with a robust, risk-based quality management system will save considerable time in the long run.	Noted
87	125	34	The second new concept relates to information and communication. Although we recognize that there is a great deal of flexibility in the proposed standards in how firm’s may design their system to address this component, the need to design procedures around this seem to result in minimal advantages to the firms.	Noted
88	130	34	We believe that the consideration of the technological, intellectual resources in addition to the existing consideration of human resources may impose a measurable burden on smaller organizations. While well intended, and particularly helpful with large national and global firms, we do not believe that for smaller firms the added cost is outweighed by the benefit of providing meaningful information to external parties about a firm’s quality management systems.	Noted
89	134	34	Information and communication We generally support the proposed requirements related to the Information and Communication component. We believe further guidance may be needed for firms to understand the boundaries of the requirement, the extent of the evidence that firms need to gather, and the documentation needed to comply. We feel the lack of guidance is particularly apparent in proposed paragraph 34(d) from the perspective of communications with service providers. Practically speaking, we are struggling to identify communications that would be necessary to third parties or non-network firms on these topics in order for those resources to fulfill their responsibilities.	Noted
90	155	34	However, we believe additional clarification related to paragraphs 34 and 47 of the proposed standard regarding the expected formality of required communications would be beneficial. For instance, paragraph 47 requests ongoing communication related to the	The formality of documentation is specific to the nature and

			<p>monitoring and remediation between those assigned operational responsibility for monitoring and remediation to those assigned ultimate responsibility and accountability for the system of quality management. The three bullets in paragraph 47 require “(a) a description of the monitoring activities performed; (b) the identified deficiencies, including the severity and pervasiveness of such deficiencies; and (c) the remedial actions to address the identified deficiencies.”</p> <p>Additional application material could be provided by expanding paragraph A186 to provide an example. For instance, is the expectation to include details regarding how a firm identified the severity and pervasiveness of a given deficiency, or is a brief summary of the deficiency appropriate? Also, for remedial actions, is it sufficient to document the developed approach for remedial actions or is there an expectation to include evidence of each remedial action taken?</p> <p>Paragraph 34 and the application guidance supporting paragraph 34 provide examples under information and communication, however it is not clear how formal the documentation supporting this communication should be. For example, one of the bullet points in paragraph A120 states that engagement teams may communicate information about the operation of the firm’s responses (for example concerns about the firm’s processes for assigning personnel to engagements). This is an ongoing process for firms, but the process for assignment of personnel may not always be formally documented. It would be helpful to have guidance/examples illustrating the expected level of documentation within the application materials.</p>	<p>circumstances of the firm. Implementation guidance on documentation would be helpful.</p>
91	158	34	<p>The proof of communication and discussion at a smaller firm may be challenging to add additional documentation to support that communication was formally adhered to, whereas a small firm may present in an informal setting or discussion.</p>	Noted
92	162	34	<p>We agree overall with the proposed standard’s information and communication aspect, but note making this fully operational may be difficult for a number of firms. For firms that issue robust internal communications and/or external transparency reports, there is a structure and mechanism for a number of communications. However, few firms issue such reports and those that do likely expend a large amount of resources to prepare and review such reports. We feel this aspect, while written in a principles-based manner, is not operational without further application guidance.</p>	Noted

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93	167	34	The information and communication addition is vague and appears to leave firms open to more scrutiny over whether or not those changes are properly implemented and being followed.	Noted
94	156	35	Paragraph 35d(ii): The firm establishes policies or procedures that address the following circumstances: The firm is obligated by law or regulation to accept a client relationship or specific engagement. We could not identify an example or scenario in which this requirement would apply. It would be helpful for the application guidance to elaborate as to what types of scenarios the ASB anticipates with this requirement.	ASB can't identify any either but this concept is in extant.
95	010	36	Evaluating identified deficiencies in the firm's system of quality management We believe additional clarity around how firms should evaluate the severity and pervasiveness of identified deficiencies would help firms more effectively implement the requirements. A lack of clarity could lead to inconsistencies in how firms evaluate deficiencies and the impact on the overall assessment of effectiveness of the system of quality management. management.	Noted for implementation guidance
96	077	36	The changes to Monitoring and Remediation which shift the focus from engagement level monitoring to monitoring of the system of quality management will bring about the desired focus on the overall system rather than only the completed engagements. This will help to review the integrated nature of the eight components of the system of quality management.	Noted
97	161 PwC	36	Monitoring and remediation  We agree with the objective of proposed SQMS No. 1 that "the firm is to design, implement, and operate a system of quality management ... that provides the firm with reasonable assurance..." In the context of proposed SQMS No. 1, it is intended that the operation of the SoQM as a whole provides the firm with such reasonable assurance. Reasonable assurance is not an absolute level of assurance, because there are inherent limitations of a SoQM. Additionally, it is neither reasonable nor cost effective for a SoQM to be designed to achieve absolute assurance. Instead, a robust monitoring and remediation process can provide a continuous feedback loop to enable firms to address any items that have come to the firm's attention through monitoring.  We believe the approach taken in proposed SQMS No. 1 would encourage a more proactive approach to monitoring and likely enhance firms' ability to prevent audit deficiencies. Developing a robust monitoring and remediation process will likely require a significant investment for those firms that do not already have robust monitoring	Supportive

		<p>techniques in place – and could present particular challenges to smaller firms or those that perform only a small number of audits. It is important for firms to develop an appropriate mix of ongoing and periodic monitoring activities. These monitoring activities can include performing pre-issuance reviews, internal inspections of completed engagements, and examination of identified deficiencies to determine root causes. The proper mix can drive quality and enhance the continuous feedback loop to prevent future engagement deficiencies, but depends on the nature and circumstances of the firm. The ASB should acknowledge that no single approach makes sense for all firms, that innovation and experimentation should be encouraged, and that smaller firms may not find the benefits of certain approaches commensurate with the costs.</p> <p>In this regard, we believe a firm should have policies and procedures addressing the evaluation of the relative severity and pervasiveness of any identified deficiencies, including the effect of the identified deficiencies, individually and in aggregate, on the firm’s SoQM. Having a principles-based requirement such as that in proposed SQMS No. 1 enables the firm to consider deficiencies that have been identified in the context of the firm’s overall design of its SoQM. Evaluating deficiencies in a firm’s SoQM is subjective and involves considerable judgment, taking into account the firm’s specific quality objectives, the related risks, and the connection between different components of the SoQM.</p> <p>Evaluating when deficiencies, individually or in aggregate, preclude a firm from concluding that its SoQM achieved reasonable assurance also requires judgment. For example, matters identified at the individual engagement level (e.g., from external inspections or financial statement issues such as restatements) are not always indicative of a deficiency and cannot necessarily be used to draw conclusions about the overall effectiveness of the SoQM. As acknowledged in proposed SQMS No. 1, evaluating whether the firm’s SoQM provides reasonable assurance also involves evaluating whether the remedial actions are (1) appropriately designed to address the identified deficiencies and their related root causes and (2) have been implemented.</p> <p>Each firm’s quality responses and monitoring and remediation process are expected to be tailored to its identified quality risks. We do not think it is necessary for the ASB to provide further direction on evaluating the severity of deficiencies or to attempt to establish specific thresholds that would preclude a firm from concluding that its SoQM was effective.</p>	
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98	162	36	We agree overall with the proposed standard’s monitoring and remediation aspect. Particularly given the “fresh look,” that the proposed QM standards may bring, we encourage appropriate implementation guidance to assist firms and their peer reviewers to have a mutual and consistent understanding of the evaluation of deficiencies.	Supportive
99	166	36	The specific area of the proposed standard that may be difficult to scale is the monitoring and remediation requirement. For small firms, using an outside person to provide this service will probably be necessary, which might be expensive and difficult. With a shortage of staff and practitioners in some practice areas and regions of the country, it may be difficult to find practitioners who are qualified and able to take on this additional work.	Noted
100	168	36	Monitoring Activities – This requirement will be significant for smaller firms; see discussion under scalability below.	Noted
101	108	39	Another area where the exposure draft seems to be overly ambitious is in the area of monitoring and remediation. Looking o ver old engagements has always seemed like a waste of time. Further more, most small firms are not members of associations. This is another area where there could be challenges that will be experienced by smaller firms in applying the standards. The monitoring for smaller firm is not going to be the same as it would be for a larger firm . Rather than adding a lot of additional rules in this area, why not require that as a part of the planning process the firm perform an inspection of the prior year's engagement documentation in order to determine, what changes need to be made, and what if any additional work will be required on the current year's engagement, in order for it to follow professional standards?	Noted; inspection is currently required.
102	086	42a	Proposed SQMS No. 1 would require a firm to tailor its monitoring procedures based on the reasons for the assessments given to the quality risks, the design of the responses, the design of the firm’s risk assessment process and monitoring and remediation process, and any changes in the quality management system, the results of previous monitoring activities, and other relevant information. As the success of the firm’s monitoring and remediation process is dependent on the effectiveness of the firm’s risk assessment process, the committees are concerned with the ability of firms to properly tailor monitoring to meet the quality control objectives. Root Cause Identification For almost 20 years, peer review committee members have noted that practitioners and peer reviewers struggle with identifying the system cause of matters, findings, and deficiencies. Adding this requirement to SQMS No. 1 may add another area where	Agree that this is an area where implementation guidance and training is needed. Noted for Content Development.

			<p>smaller firms will not succeed. We anticipate many peer review findings that highlight that the firm did not identify an appropriate root cause, and as a result failed to implement an appropriate remedial response.</p>	
103	119	42a	<p>Proposed SQMS No. 1 would require a firm to tailor its monitoring procedures based on the reasons for the assessments given to the quality risks, the design of the responses, the design of the firm's risk assessment process and monitoring and remediation process, and any changes in the quality management system, the results of previous monitoring activities, and other relevant information. As the success of the firm's monitoring and remediation process is dependent on the effectiveness of the firm's risk assessment process, we are concerned with the ability of firms to properly tailor monitoring to meet the quality control objectives.</p> <p>Root Cause Identification</p> <p>For almost 20 years, peer review committee members have noted that practitioners and peer reviewers struggle with identifying the system cause of matters, findings, and deficiencies. Adding this requirement to SQMS No. 1 may add another area where smaller firms will not succeed. We anticipate many peer review findings that highlight that the firm did not identify an appropriate root cause, and as a result failed to implement an appropriate remedial response.</p>	<p>Agree that this is an area where implementation guidance and training is needed. Noted for Content Development.</p>
104	103	42a	<p>The shift of focus from the engagement level to the entire system of quality management is a positive change steered by the four factors listed on page 15 of proposed SQMS No. While focusing on the design of the underlying system, the nature and circumstances of the firm and engagements it performs, the extent of changes to the system, and the results of other internal and external monitoring activities improves the monitoring process, we believe that additional guidance on monitoring activities will improve consistency on evaluating the system of quality management. This consistency will enable firms and peer reviewers to appropriately evaluate the system of quality control. We suggest consideration of the following:</p> <p>We strongly support the AICPA's consideration of implementation guidance that will assist firms and peer reviewers in the assessment and understanding of the evaluation of deficiencies. We recommend this additional guidance include options for small and mid-size firms with limited resources who might have a difficult time implementing an ongoing monitoring system.</p> <p>In general, auditors are not trained or skilled in root cause analysis. The requirement to perform an effective root cause analysis will potentially be a significant challenge for</p>	<p>Agree, noted</p>

			<p>many firms, particularly those that are small and mid- size. Devoting internal resources to evaluate findings, identify deficiencies, assess the pervasiveness of deficiencies, and establish and monitor a remedial action plan, when necessary, may be near impossible with small and mid-size firms since objectivity and the ability to identify what one does not know could be compromised. These requirements may require a small or mid-size firm to seek external resources that could be costly and potentially expose the firm’s weakness to market competitors.</p> <p>Proposed SQMS No. 1 calls for at least an annual evaluation of the system of quality management to conclude whether the system provides the firm with reasonable assurance that the objectives of the system are being achieved. Additional guidance on the objectives of the evaluation and the formality of the conclusion reached would enhance the process, increase consistency, and clarify how small to mid-size firms can meet this requirement. The Information and Communications section addresses external communications. Firms may use results to include data in their “transparency reports” or other marketing material, provide information to potential and existing clients, or provide information to other regulators.</p> <p>See our comments in the Governance and Leadership section regarding monitoring by the leaders of the firm.</p> <p>Overall, the proposed requirements are very conceptually driven, with little guidance on practical implementation. As noted above, we think that practice aids or similar tools would be extremely beneficial. Since this proposed standard is working toward converging with the IAASB standard, we recommend issuing implementation guides that build on those published by the IAASB. The ASB can use research performed by the IAASB to potentially incorporate additional improvements into this guidance.</p>	
105	134	42a	<ul style="list-style-type: none"> <li>• Monitoring and remediation</li> </ul> <p>We believe that the proposed standard would improve firms’ monitoring of their system of quality management as a whole and would promote more proactive and effective monitoring activities.</p> <p>We agree with the incorporation of a new requirement to investigate the root cause of identified deficiencies and believe that the guidance allows for sufficient flexibility. We further support the inclusion of guidance that explains that the procedures undertaken to understand the root cause of an identified deficiency may be simple, considering the term “root cause analysis” is often associated with a complex, in-depth process. Further, we believe the application guidance added from International Standard on Quality Management (ISQM) 1 would be</p>	<ul style="list-style-type: none"> <li>• Noted</li> </ul>

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			<p>useful for firms in determining when they have performed sufficient analyses of the cause of the deficiency.</p> <p>We note, however, that even firms that perform effective root cause analyses are unlikely to drive 100% quality firmwide. In other words, root cause analysis is good for identifying and addressing systemic quality issues across a firm, but it will not eliminate those “one off” deficiencies that result from human error. A firm’s system of quality management provides reasonable, not absolute, assurance.</p> <ul style="list-style-type: none"> <li>In addition, it is unclear to us when the evaluation of identified deficiencies is intended to occur. We question whether the Board intends for a deficiency to be evaluated once it is identified or if such evaluation is intended to coincide with the annual evaluation made by the individual at the firm who is ultimately responsible for the system of quality management. We ask the Board to consider adding application guidance to help clarify this timing question.</li> </ul>	<ul style="list-style-type: none"> <li>If the timing is unspecified in the standard, the firm uses professional judgment to perform the evaluation, at least annually. For implementation guidance.</li> </ul>
106	155	42a	<p>The exposure draft includes a new requirement to evaluate root causes of deficiencies. We believe that smaller firms may have some challenges with the identification of root causes. This is an area that can be expanded with additional illustrations and examples in the application material and/or developed implementation materials.</p>	Agree, noted
107	089	47-48	<p>Sections 47-48: The form of communication (written or verbal) and the retention of such communication (as part of the engagement file or as part of a monitoring file), and the period of retention should be specified; this information could be useful for peer reviewers evaluating the operation of the monitoring and remediation program of the firm.</p>	Noted for implementation guidance; too prescriptive for requirement.
108	089	58-61	<p>Sections 58-61: The proposed standard should be more specific in the type of documentation that satisfies this requirement. Is a written Quality Management document required for all firms, regardless of size? For any firm? Are written monitoring reports required? Clarity and specificity here will avoid creating significant problems for peer reviewers attempting to identify and evaluate the requirements of and compliance with the firm’s Quality Management policies and procedures.</p>	Noted for implementation guidance; too prescriptive for requirement.
109	092	57	<p>Evaluating the System of Quality Management Clarification of the requirements in paragraph .57 and related application guidance regarding the periodic performance evaluations of those assigned the operational responsibility for the system of quality management. As written, the requirements infer that failures detected in monitoring would be due to negative performance when other root causes could exist.</p>	Hence the requirement to perform a root cause analysis of the deficiencies.

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110	081	40	However, we strongly believe paragraphs 40b, A168, and A169 prevent the scalability of the standards to sole proprietors and small firms and would require them to outsource monitoring activities to external service providers.	Agree, revisions proposed.
111	134	48	We believe further guidance is necessary for the appropriate application of paragraph 48 of the proposed standard. Due to the operational challenges created by the proposed definition of “engagement team,” it is unclear to what extent the matters are communicated to component auditors (or other auditors) who are either network firms or other firms. A literal application of this requirement could divulge sensitive, confidential, or privileged information to third parties that do not have a need to know such information. A firm’s system of quality management addresses the use of network firms and services providers; network firms and services providers themselves are not part of a firm’s system of quality management. We recommend adding language to this paragraph such as “to the extent relevant to their responsibilities” to avoid onerous and unnecessary communication expectations.	Paragraph already says “in accordance with their responsibilities”; no change. Principles-based standards require professional judgment, which should exclude communicating confidential information to those with no need to know it.
112	077	49	The inclusion of Network considerations is an important aspect of SQMS 1. This will add an additional element to the system of quality management which may have not been considered under previous standards.	Supportive
113	109	49	The Committee feels there will be difficulty with implementation around networks. As noted in Par. 49-50, the firm will need to wait on their network to determine the quality risks and responses that the network feels all their network firms should address, then each firm will need to evaluate the information provided by the network to determine if and how much modification will be required to meet the firm's specific quality risk areas. We feel creating a risk-based quality management system to address each firm's individual situation could significantly reduce the value of network resources provided in this area. The requirement in Par. 52a to "understand the overall scope of the monitoring activities undertaken by the network across the network firms, including monitoring activities to determine those network requirements are appropriately implemented across the network firms, and how the network will communicate the results of its monitoring activities to the firm," puts a significant burden on small firms to oversee the network and other network firms. Many small firms join networks specifically to reduce their need to "recreate the wheel" on firm administration and practice. Many of these small firms may leave these networks to avoid having to perform this process.	Noted. The belief is that networks will provide this information to avoid having firms leave. Post-implementation review of IAASB standards will show whether this belief is correct, and the ASB will consider those results.
114	168	49	Network Requirements or Network Services – The committee feels that this places a large burden on firms that belong to a network where the lead firm in the network is	See comment above. Implementation guidance will

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			significantly larger, has much more well-established policies and procedures than the smaller member firms. We think the quality management decisions of member firms in an association should be left as a practice decision of the association since they bear the ultimate risk to the result of firms using their network resources. In addition, smaller firms may not have the resources to fulfill the responsibilities required.	address the difference between networks that affect SoQM and/or engagement performance and those that don't.
115	134	49	<p><b>Networks</b></p> <p>We understand the rationale for including requirements for using network firms and their services, and we agree that it is important not to place undue reliance on services and resources provided by the network in order to achieve quality. We are concerned, however, by the focus and the extent of the proposed guidance on networks. We agree that the individual firm should be responsible for its own system of quality management, and we support the proposed standard addressing service providers. However, we do not agree with treating the network the same as a service provider. Unlike a service provider, a network shares the same reputation as the firms within the network and has a vested interest in promoting quality within the individual member firms. Arguably, the risks to quality are more extensive at firms that do not have access to the extensive resources a network can provide, yet the standard appears to be placing more of a burden on firms that participate in network resources.</p> <p>The proposals require firms to understand the network requirements, network services and resources, and any responsibilities that the firm itself may have to implement when using those services and resources. The related application material provides examples of the types of inquiries and documentation that the firm may consider in performing its assessment, but it provides little or no guidance on the extent of that assessment or on the extent of the documentation required as evidence that the firm has performed the assessment. We recommend that such guidance be incorporated into the proposed standard to guide firms in determining what systems or protocol they need to have in place to fulfill the requirements of the standard.</p>	<ul style="list-style-type: none"> <li>• Noted for implementation guidance</li> </ul>
116	160	49	<p>This document devotes much discussion to the concept of networks and network firms. This is an isolated topic and does not apply to most firms. I suggest this should be covered in a separate standard similar to SQMS No. 2 so as not to dilute the standard. Firms will tend to lose focus on the important elements when trying to absorb materials that are not relevant to them. The discussion for the Proposed SQMS No. 2 under “Why a Separate Standard?” includes a bullet point that is on point “Increasing the scalability of proposed SQMS No. 1 by not including requirements that would be irrelevant..” This same rationale should apply to the discussion of Networks.</p>	<p>Interesting idea, but no change. The network concepts are largely concentrated together and labeled so someone could skip past it if it wasn't applicable.</p>

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117	162	49	We agree overall with the proposed standard’s networks aspect and believe it appropriate to refocus firms on the importance of understanding networks. Also, some networks may find it appropriate to provide a package to member firms listing out how it complies with quality management standards in various areas to facilitate this understanding.	Noted.
118	086, 119	58	The documentation requirements included in proposed SQMS No. 1 will be an additional burden on firms with smaller practices; especially if the risks change throughout the course of the year, resulting in the need to review the related documentation multiple times a year. Supporting practice aids and examples of such documentation will be needed to ensure practitioners understand the expectations.  Additionally, the use of the term “consistent” is not entirely clear in Paragraph 58 of SQMS No. 1: “Support a consistent understanding of the system of quality management by personnel, including an understanding of their roles and responsibilities with respect to the system of quality management and performing engagements.” “Support the consistent implementation and operation of the responses.”	Noted.  No change.
119	089	59	Section 10: This should specifically state that such annual evaluation must be documented, to avoid uncertainty for peer reviewers trying to evaluate compliance with this requirement.	Agree, revision proposed
120	149	58	Lastly, your exposure draft communication letter specifically states that the proposed standards would include more robust performance and “documentation” requirements. There are already far to robust documentation requirements which result in me spending almost as much time documenting the engagement as actually performing the engagement. The paperwork aspect of auditing is in my opinion out of control. I feel like I have to document the fact that I am documenting a certain aspect of the engagement. Then I have to go back in somewhere else in the documentation and re-document that I documented the documentation. I actually used to enjoy most of the aspects of the auditing engagement but the documentation requirements are pretty quickly eliminating that.	Noted
121	155	58	We believe the proposed standard, particularly the application guidance acknowledges scalability and provides some guidance in those cases where scalability is helpful for smaller firms. However, there will be minimum documentation requirements regardless of firm size. Accordingly, more robust illustrations of sample policies and procedures would be helpful. For example, the definition of “Response” in paragraph .17 states that	Noted for implementation guidance

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			<p>policies “may be documented, explicitly, stated in communications, or implied through action and decisions.” There should be clear guidance on how actions and decisions could provide implied communication. It may be difficult to assess whether the requirements of the standards are met if too much is allowed to be implied when scaling for different sized firms. Furthermore, paragraph A53 discusses the need for more formality in larger firms, and paragraph A54 discusses “informal policies and procedures” in less complex firms. It may be difficult to assess whether a firm understands and has implemented the requirements in the standard if additional guidance regarding minimum documentation expectations are not provided.</p>	
122	163	58	<p>We are concerned with the level of effort necessary to comply with certain requirements, including documentation levels and depth of detail, and can foresee that it will be unclear to determine whether a requirement has been met, which can cause a problem for Peer Review and compliance. For example, the documentation requirements of the risk assessment process have the potential to be onerous for small firms without further clarity for small firm expectations. Again, how much documentation is enough? How deep of each category/step in process does the related documentation need to go? This is all unclear. Clear parameters, specific guides, practice aids considering the needs of smaller firms are a must. Quality Control systems in the US are Peer reviewed and if there is not clarity, the varying judgement of individual peer review firms will be unevenly applied in compliance assessments.</p> <p>Generally, the additional illustrations or practice aids are needed.</p> <p>Small firm examples and details on the extent of documentation for risk assessment</p> <p>Specifics about what conditions, events, circumstances, actions/inactions, if any, that should be assessed at high for quality risks, etc.</p>	Noted
123	160	61	<p>The proposed standard appears to have removed the requirement to retain documentation until after peer reviews or other external monitoring/oversight program activities (QC Section 10.63). I believe this element should be reinstated into the QM standard so that it is clear to practitioners this documentation should be retained, rather than through a reference to another standard. Paragraph A222 addresses certain documentation requirements and could easily be expanded to include this element. Paragraph 61 could add the period should include not only for the firm’s use, but for the use of outside regulatory parties, such as peer reviews, PCAOB, or other.</p>	Added “peer reviewer”
124	010	A14	<p>A14 Quality risks and responses to risks relevant to group audit engagements</p> <p>Paragraph A14 states that quality risks and the responses to those risks relevant to group audit engagements may be different for engagement team members who are firm</p>	Noted for implementation material

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			<p>personnel than for engagement team members who are external to the firm. However, it is not clear what the different response at the firm level would be. If the intention of the Board is to highlight a different response at that level, additional examples and implementation guidance providing clarity as to how that response differs from the response at the individual engagement team level would be helpful. Alternatively, if the intention is that the different response is solely at the engagement team level, we believe this section could be clarified by referring to the guidance for engagement teams in the Proposed QM SAS.</p>	
125	143	A14	<p>Given the ongoing standard setting activities related to AU-C 600, D&amp;T recommends that references to audits of group financial statements in proposed SQMS No. 1 be limited only to those that are necessary. If the ASB believes that further clarification or examples are needed with respect to these paragraphs, this should be done via conforming amendments as a result of the AU-C 600 standards setting project. The following edits are therefore recommended:</p> <p><i>A14. Proposed SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i> provides guidance in applying the definition of engagement team in the context of an audit of financial statements. AU-C section 600, <i>Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)</i>, expands on how proposed <i>SAS Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards</i> is to be applied in relation to an audit of group financial statements. <del>The quality risks and responses to those risks relevant to group audit engagements may be different for engagement team members who are firm personnel than for engagement team members who are external to the firm (for example, engagement team members who are from network firms or are service providers, such as component auditors from firms not within the firm's network).</del></p>	No change
126	143	A29	<p>Paragraph A29 D&amp;T recommends that a footnote reference be added pertaining to the second bullet relating the professional standards that are applicable when performing a preparation of financial statements engagement. Footnote 1: Engagements to prepare financial statements are conducted in accordance</p>	Added language in paragraph.

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			with AR-C section 70, Preparation of Financial Statements, of the Statements on Standards for Accounting and Review Services.	
127	143	A42	D&T believes that both internal and external sources of information may be relevant (i.e., we do not believe it is appropriate to always identify only one relevant source (for example, an internal source) and in doing so always exclude other information merely because it is obtained from another source (for example, an external source)). We recommend the following change to paragraph A42 of proposed SQMS No. 1: A42. ... Other information, <del>either</del> <b>both</b> internal or and external, may also be relevant to the firm’s risk assessment process, such as the following: ...	<ul style="list-style-type: none"> <li>Revised to “whether”</li> </ul>
128	156	A44	Paragraph A44: The nature and circumstances of the firm and its engagements may be such that the firm may not find it necessary to establish additional quality objectives. Given the comprehensive nature of the quality objectives established in SQMS No. 1, most firms would have reasonable assurance that any relevant quality objective is achieved if those in SQMS No. 1 are met. We understand there may be rare circumstances where additional objectives are warranted. Paragraph A44 provides guidance that additional quality objectives may not be necessary, but we would like this wording to be stronger to indicate that identifying additional objectives is likely the exception rather than the rule.	Agree. See QM 1 for options for revision
129	143	A51	D&T believes the nature, timing, and extent of the responses is not determined based on conclusions relating to the reasons for the assessment given to the quality risks; rather, it is considerations of the occurrence and effect of such reasons on the achievement of the quality objective(s) that do so. Further, paragraph A51 of proposed SQMS No. 1 addresses the effect on the achievement of one or more quality objectives but does not address the likelihood that the quality risk may actually occur. We recommend reverting to the wording as outlined in paragraph A49 of ISQM 1 as follows: A51. The nature, timing, and extent of the responses are based on the reasons for the assessment given to the quality risks, <del>that is, the conclusions from the consideration of how, and the degree to which, conditions, events, circumstances, actions, or inaction may adversely affect</del> <b>which is the considered occurrence and effect on</b> the achievement of one or more quality objectives.	Agree but used wording from par. A47 that is consistent with definition of quality risk.

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130	128	A51	In addition, we noted that paragraph A51 within SQMS 1 could replace the term “inaction” with the word “inactions” to be consistent with terminology used throughout SQMS 1.	Agree but moot given revision above.
131	162	A57	<p>On .A57, while we do agree that “The firm’s culture is an important factor in influencing the behavior of personnel,” we do recommend that on the list of “Professional values and attitudes” listed, that “Social responsibility” be removed, in part, for the following reasons:</p> <p>The concept of social responsibility has different definitions to different people and such definitions may be in conflict with one another. However strongly one feels for or against whatever definition of social responsibility is used, we feel such consideration is not relevant with quality management in the context of this proposed SQMS.</p> <p>By including social responsibility in .A57, even though it is application guidance, it may imply that social responsibility should be a part of quality management and that peer reviewers should include consideration of such in the peer reviewers’ inspections, which given the different definitions of social responsibility, could create issues that detract from audit quality.</p>	Disagree; deleting would send a message that ASB devalues social responsibility. Firms may use whatever definition they like; if definitions differ, well, so do firm cultures.
132	143	A68	<p>With respect to paragraph A68 of proposed SQMS No. 1 we also noted that: The phrase “component auditors are” is used, which is inconsistent with the singular form of the phrase in paragraph A46 of proposed SQMS No. 1. We recommend that the wording be aligned.</p> <p>Footnote 7 paraphrases ET section 0.200.020 of the AICPA code. We recommend that the footnote either cross-reference the AICPA code only (i.e., without further explanation) or that the footnote more closely restate the wording in the AICPA code as noted below.</p> <p>The following edits are therefore recommended: A68. AU-C section 600 states that when <del>the</del> component auditors <del>are</del> <u>is</u> not subject to the AICPA code, compliance 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 (footnote 7). <del>Procedures the firm may use regarding the fulfillment of relevant ethical requirements that apply to network firms, employees of network firms, or service providers may include confirmations, letters of representation, or other affirmations.</del></p>	<ul style="list-style-type: none"> <li>• AU-C 600.A46, to which par. A68 refers, does use the singular – revised A68.</li> <li>• last sentence revised but not deleted</li> <li>• Agree, revised.</li> </ul> <p>Note the use of “explains” denotes that what follows is not an exact quote. The exact</p>

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			<p>Footnote 7. The section, “Application of the AICPA Code” (ET <del>section-</del> 0.200.020), of the AICPA Code of Professional Conduct (AICPA code) explains that an AICPA member who is <del>a</del> the group engagement partner <b><u>will not be considered in violation of the AICPA code if a</u></b> <del>of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA code, provided that component auditors</del> <b><u>practicing outside the United States departs from the AICPA code with respect to the audit or review of group financial statements as long as the component auditor’s conduct, at a minimum, is in accordance</u></b> <del>that are not subject to the AICPA code are in compliance with the ethics and independence requirements set forth in the International Federation of Code of Ethics</del> <b><u>for Professional Accountants, and the members of the group engagement team are in compliance with the AICPA code.</u></b></p>	<p>wording of the ET sec. is as follows: AICPA member who is a member of a group engagement team will not be considered in violation of the AICPA Code if a component auditor operating outside the United States departed from any of the rules stated herein with respect to the audit or review of <i>group financial statements</i> or other <i>attest engagement</i>, as long as the foreign component auditor’s conduct, at a minimum, is in accordance with the ethics and <i>independence</i> requirements set forth in the International Ethics Standards Board for Accountants’ (IESBA’s) Code of Ethics for Professional Accountants, and the members of the group engagement team are in compliance with the rules stated therein.</p>
133	143	A78	<p>D&amp;T believes that it would add further clarity to include footnote references to the AICPA code that address fees and other types of remuneration, including the importance of entering into fee arrangements that are commensurate with quality services being performed, which is a matter of public interest. A78. ... The AICPA code addresses fees and other types remuneration (footnote 1). Footnote 1. ET section 0.300.030.04 of the AICPA code.</p>	<p>Agree, revised</p>

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134	061	A122	<p>The guidance on internal communication seems to codify existing practice of most firms. The guidance on external communications could be potentially problematic if it is in conflict with the AICPA Code of Professional Conduct or the requirements of individual State Boards. For example, paragraph A122 seems to assume that Non-Compliance with Laws and Regulations (“NOCLAR”) will be approved by the ASB, although that is not the case at this point.</p>	<p>Examples state that these may exist but not that they do. First example is unrelated to current NOCLAR ED.</p>
135	040	A124	<p>We suggest that the ASB modify paragraph A124 because the sentence that we underlined conveys a requirement.</p> <p>Paragraph A124: The specified responses may address multiple quality risks related to more than one quality objective across different components. For example, policies or procedures for complaints and allegations may address quality risks related to quality objectives in resources (for example, personnel’s commitment to quality), relevant ethical requirements, and governance and leadership. <u>The specified responses alone are not sufficient to achieve the objectives of the system of quality management.</u></p> <p>We suggest that the ASB either add a requirement to paragraph 27, such as “The firm should design and implement responses to address the quality risks in addition to those listed in paragraph 35,” or remove the requirement language in paragraph A124.</p>	<p>Paragraph 27 already requires this. Moved underlined sentence to paragraph 27 as essential guidance.</p>
136	143	A126	<p>We believe that certain text, which was not included in ISQM 1, in paragraph A126 of proposed SQMS No. 1 is superfluous and should be deleted as follows: A126. Relevant ethical requirements may specify how the firm is required to respond to a breach. For example, the “Breach of an Independence” interpretation (ET section. 1.298.010) of the “Independence Rule” (ET section. 1.200.001) contains guidance addressing a breach of an independence interpretation of the AICPA code, <del>which also contains guidance addressing a breach of any other provision of the AICPA code.</del></p>	<p>Disagree, no change.</p>
137	010	A140	<p>A140 Communication about firm’s system of quality management to governmental organizations Paragraph A140 introduces the concept that the firm may take into account the size and complexity of a governmental organization, the range of its stakeholders, the nature of the services it provides, and the roles and responsibilities of those charged with governance when determining whether it is appropriate to communicate to those charged with governance of a governmental organization about the firm’s system of quality management. It is not clear how various organizational and operational aspects of</p>	<p>No change.</p> <p>GAO didn’t object. This may be referring to situations where TCWG of a governmental organization don’t select the firm, but the firm audits them as part of a group.</p>

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			the governmental organization subject to the services a firm provides influences whether it is appropriate to communicate information about the firm’s system of quality management. We also do not believe that the considerations for communicating to a governmental organization should be different than those for communicating to those charged with governance in paragraph A139. We suggest aligning the guidance for engagement of governmental organizations with that for other entities or clearly delineating why different considerations are necessary.	
138	040	A140	The heading between SQMS No. 1 paragraphs A140 and A141 should be in italics.	Fixed
139	128	A145	We noted the ASB has replaced the term “engagement quality control review” with “engagement quality review.” Thus, we recommend updating paragraph A145 in Proposed SQMS 1 to replace the use of the phrase “engagement quality control review” with “engagement quality review” to align with the convergence terminology.	Revised
140	161 PwC	145	<p>Determination of engagements subject to EQR requirements</p> <p>We agree with the decision to include the requirement to determine engagements to be subject to an EQR within proposed SQMS No. 1. We also support the premise of paragraphs A144 and A145 in proposed SQMS No. 1 that, in some cases, a firm’s response to addressing one or more quality risks may be achieved through an EQR. This guidance suggests the firm may wish to consider whether EQRs should be required for entities that may have public interest or public accountability characteristics. While we understand the intent of this guidance, we believe that the lack of a global definition of a PIE may cause difficulties for global firms looking to adopt a common framework across their networks. It remains necessary for firms to retain the ability to determine which engagements should be subject to EQRs beyond audits of listed entities.</p> <p>We believe the ongoing project by the International Ethics Standards Board for Accountants to broaden the definition of PIEs could also have unintended consequences in the US and encourage the ASB to liaise with the Professional Ethics Executive Committee to understand if additional clarification is needed in regard to the determination of engagements subject to EQRs.</p>	Noted
141	161 PwC	145	We agree with including how to determine engagements subject to an EQR within proposed SQMS No. 1. We also support the premise of paragraphs A144 and A145 in proposed SQMS No. 1 that, in some cases, a firm’s response to addressing one or more quality risks may be achieved through an EQR. This guidance suggests the firm may wish	Noted

			to consider whether EQRs should be required for entities that may have public interest or public accountability characteristics. While we understand the intent of this guidance, we believe it remains necessary for firms to retain the ability to determine which engagements should be subject to EQRs beyond audits of listed entities.	
142	040	150	<p>We suggest that the ASB delete paragraph A150</p> <p>Paragraph A150: Monitoring activities may include the inspection of in-process engagements. Inspections of engagements are designed to monitor whether an aspect of the system of quality management is designed, implemented, and operating in the manner intended. In some circumstances, the system of quality management may include responses that are designed to review engagements while they are in the process of being performed that appear similar in nature to an inspection of in-process engagements (for example, reviews that are designed to detect failures or shortcomings in the system of quality management so that they can prevent a quality risk from occurring). The purpose of the activity drives its design and implementation and where it fits within the system of quality management (that is, whether it is an inspection of an in-process engagement that is a monitoring activity or a review of an engagement that is a response to address a quality risk).</p> <p>We believe that it is inappropriate to have inspections of in-process engagements. We believe that in-process reviews should be considered part of the engagement quality management process, not a monitoring activity. Further, unless an audit organization’s quality management system is permitted to function through the completion of the engagement, the audit organization cannot determine whether a potential finding or deficiency would have been identified and rectified through the quality management process. An in-process inspection may interrupt the quality management process, thereby affecting the audit organization’s ability to rely on the system of quality management.</p> <p>It is also our view that inspecting in-process engagements could blur the distinction between quality management within individual engagements and the quality objective related to the monitoring and remediation process. As a result, permitting inspections of in-process engagements may cause additional difficulties in applying the quality management standards.</p>	<p>Disagree, no change.</p> <p>In-process inspections are permitted, not required. If they cause difficulty, firms need not do them.</p>

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143	109	A155	<p>The monitoring and remediation process requests that firms use a lot of judgment in determining what is a deficiency and the pervasiveness of that deficiency. The guidance states in Par. A155, "In a less complex firm, the monitoring activities may be simple because information about the monitoring and remediation process may be readily available in the form of leadership's knowledge, based on their frequent interaction with the system of quality management, of the nature, timing, and extent of the monitoring activities undertaken, the results of the monitoring activities, and the firm's actions to address the results." Given the standard of "if it is not documented, it did not happen," guidance should emphasize documenting the leadership's knowledge in a memo to allow others to access it without having to contact leadership repeatedly.</p> <p>The Committee does agree with a cyclical rotation of inspecting each partner's engagements. This rotation will help create a team atmosphere and prevent avoiding a bad partner to avoid conflict.</p>	Noted for implementation guidance.
144	156	A165	<p>Paragraph A165: Examples of policies and procedures that a firm may establish to apply a cyclical basis for the inspection of completed engagements for each engagement partner include the following policies or procedures that set forth the standard period of the inspection cycle, such as the inspection of a completed engagement for each engagement partner performing audits of financial statements once every three years, and for all other engagement partners, once every five years.</p> <p>Providing specific cycles for inspection (3 and 5 years) in the application guidance may have the effect of being presumptively mandatory. Firms should be permitted to set their own cycles. Thus, we suggest revising the guidance to address having different cycles based on the nature of the work engagement partners perform without specifying cycles (e.g., once every X and Y years).</p>	See proposed revision to emphasize this is an example.
145	143	A167	<p>When referencing paragraphs A148 through A186 of proposed SQMS No. 1 relating to the Monitoring and Remediation Process, D&amp;T noted that the phrases "monitoring activities" and "an inspection" were used in the guidance rather than "monitoring procedures" and "inspection procedures." Further, throughout ISQM 1, "the firm" has been used rather than "a firm," in order to more specifically emphasize that the SOQM is applicable to an individual firm. Likewise, ISQM 1 also consistently references "policies or procedures." D&amp;T recommends that the following edits be made for consistency:</p> <p>A167. A peer review is not a substitute for all monitoring <del>activities</del> <u>procedures</u>.</p>	Agree, revised

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			<p>However, because the objective of a peer review is similar to that of <b>an</b> inspection <del>procedures</del>, a <b>the</b> firm’s quality control <b>management</b> policies <del>or and</del> procedures may provide that a peer review conducted under standards established by the AICPA may be a substitute for the inspection of engagement documentation, reports, and clients’ financial statements for some or all engagements for the period covered by the peer review.</p>	
146	081	A168	<p>However, we strongly believe paragraphs 40b, A168, and A169 prevent the scalability of the standards to sole proprietors and small firms and would require them to outsource monitoring activities to external service providers.</p>	Revised
147	156	A168	<p>Paragraph A168 of SQMS No. 1 notes that a self-review threat may arise when an individual who performs another type of monitoring activity participated in designing, executing, or operating the response being monitored. Many mid to large size firms support national practice groups that perform administrative functions over audit practices such as developing quality management policies, designing audit methodologies, and creating tools and templates to promote understanding and consistency. It would seem that such functions then create a self-review threat if those involved then plan or coordinate an internal inspection, even if not performing inspections themselves. It would be very helpful to address this common scenario in terms of considerations when assessing the self-review threat and safeguards that could be employed.</p>	Clarified
148	163	A168	<p>We are concerned with aspects of the Responsibility for the SOQM and Monitoring and Remediation portions of SQMS 1. A) We are concerned with the possible implication that the person(s) who design the inspection system cannot also be responsible for monitoring/internal inspection. B) Also specifically related to the Prohibition of Self Inspection including EQR. A) At small firms such as ours an attest partner is responsible for overall quality and another attest partner is responsible for implementation. Both partners have commercial attest work and both partners perform EQR. This actually enhances quality as the buck stops at the top so to speak. For the EQR, small firms do not typically have the volume of qualified personnel necessary to meet these requirements. Our firms are already subject to Peer Review and compliance is monitored through that process. This requirement seems to presume lack of objectivity and bias. Suggestion: However, we strongly feel that this threat could be alleviated via the required use of a uniform, detailed checklist. Our US based system has a long history of self-regulation, and this is no exception. The use of checklist could overcome this concern in a far less</p>	Revised

			onerous way that would cure the issue without undue cost or burden on smaller firms unequally	
149	040	A168	<p>Paragraph A168: The provisions of relevant ethical requirements are relevant in designing the policies or procedures addressing the objectivity of the individuals performing the monitoring activities. A self-review threat may arise when an individual who performs</p> <ul style="list-style-type: none"> <li>• an inspection of an engagement was                             <ul style="list-style-type: none"> <li>— in the case of an audit of financial statements, an engagement team member or the engagement quality reviewer of that engagement or an engagement for a subsequent financial period, or</li> <li>— for all other engagements, an engagement team member or the engagement quality reviewer of that engagement.</li> </ul> </li> <li>• another type of monitoring activity participated in designing, executing, or operating the response being monitored.</li> </ul> <p>Paragraph A169: In some circumstances, for example, in the case of a less complex firm, there may not be personnel who have the competence, capabilities, time, or objectivity to perform the monitoring activities. In these circumstances, the firm may use network services or a service provider to perform the monitoring activities.</p> <p>We believe that paragraphs A168 and A169 imply that small governmental audit organizations that are required to follow the SQMS would have to contract with service providers to perform all monitoring activities. We acknowledge that there is a self-review threat when individuals monitor a response that they helped to design, execute, or operate. GAGAS paragraph 5.48 states, “Monitoring is most effective when performed by persons who do not have responsibility for the specific activity being monitored.” However, we believe that there are measures that could be implemented to mitigate this threat to objectivity. For example, third-party inspections would mitigate at least some of the self-review threat discussed in paragraph A168. As such, it is possible that individuals within small governmental audit organizations could perform certain monitoring activities.</p>	Revised

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150	102	A168	<p>The Committee under paragraph A168 sees the wording "A self-review threat may arise when an individual who performs another type of monitoring activity participated in designing, executing or operating the response being monitoring." The Committee is unclear what this means and asks for further clarification via examples and/or other explanatory material.</p> <p>The present interpretation of A168 is that the individual who designed, executed or operated the system is ineligible to be part of the inspection of the system. This will be a burden to the small and medium sized firm.</p>	Clarified
151	040	A168	<p>The underlined portions of paragraphs A168 and A169 could affect the scalability of the SQMS No. 1.</p>	Revised
152	143	A194	<p>D&amp;T believes that the example related to “the use of individuals from other network firms as component auditors” as reflected in paragraph A179 of ISQM No. 1 should be reinstated in paragraph A194 of proposed SQMS No. 1 as it is helpful and reflects current circumstances that occur in practice. Further, this is an illustrative example rather than a requirement and should be viewed in that context.</p> <p>A194. ...</p> <p>Network requirement or network service          How the firm adapts or supplements the network requirement or network service          The firm uses individuals from other network firms as component auditors. Network requirements are in place that drive a high degree of commonality across the network firms’ systems of quality management. The network requirements include specific criteria that apply to individuals assigned to work on a component for a group audit.          The firm establishes policies or procedures that require the engagement team to confirm with the component auditor (i.e., the other network firm) that the individuals assigned to the component meet the specific criteria set out in the network requirements.</p>	Added
153	040	A213	<p>We believe that additional clarification is needed in paragraph A213. It is unclear what the ASB means by an independent assurance report on its system of quality management:</p> <p>Paragraph A213:          This proposed SQMS does not require the firm to obtain an independent assurance report on its system of quality management or preclude the firm from doing so.</p>	This means you don’t have to get a peer review report in the other two years. Added example

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154	162	A223	<p>Given the varying expectations that will likely exist among peer reviewers and other parties, we recommend .A223 be retained and considered to be elevated to a requirement.</p> <p>The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction for each quality objective or each risk that may give rise to a quality risk. However, in documenting the quality risks and how the firm’s responses address the quality risks, the firm may document the reasons for the assessment given to the quality risks (that is, the considered occurrence and effect on the achievement of one or more quality objectives) to support the consistent implementation and operation of the responses.</p>	<p>Not sure what is meant by “retained”. Overly prescriptive to elevate to a requirement.</p>
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## PROPOSED STATEMENT ON QUALITY MANAGEMENT STANDARDS *ENGAGEMENT QUALITY REVIEWS*

### Introduction

#### Scope of This Proposed Statement on Quality Management Standards

1. This proposed Statement on Quality Management Standards (SQMS) addresses the following:
  - a. The appointment and eligibility of the engagement quality reviewer
  - b. The engagement quality reviewer's responsibilities relating to the performance and documentation of an engagement quality review
2. This proposed SQMS applies to all engagements for which an engagement quality review is required to be performed in accordance with proposed SQMS *A Firm's System of Quality Management*, including when the firm has determined that an engagement quality review is an appropriate response to assessed quality risks.<sup>1</sup> This proposed SQMS is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements.
3. An engagement quality review performed in accordance with this proposed SQMS is a specified response that is designed and implemented by the firm in accordance with proposed SQMS *A Firm's System of Quality Management*.<sup>2</sup> The performance of an engagement quality review is undertaken at the engagement level by the engagement quality reviewer on behalf of the firm.

#### Scalability

4. The nature, timing, and extent of the engagement quality reviewer's procedures required by this proposed SQMS vary depending on the nature and circumstances of the engagement or the entity. For example, for engagements involving fewer significant judgments made by the engagement team, the engagement quality reviewer's procedures would likely be less extensive.

#### The Firm's System of Quality Management and Role of Engagement Quality Reviews

5. Proposed SQMS *A Firm's System of Quality Management* establishes the firm's responsibilities for its system of quality management and requires the firm to design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks.<sup>3</sup> The specified responses in

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<sup>1</sup> Paragraph 35f of proposed Statement on Quality Management Standards (SQMS) (Previously Statement on Quality Control Standards) *A Firm's System of Quality Management*.

<sup>2</sup> See footnote 1.

<sup>3</sup> Paragraph 25 of proposed SQMS *A Firm's System of Quality Management*.

proposed SQMS *A Firm's System of Quality Management*<sup>4</sup> include establishing policies or procedures addressing engagement quality reviews in accordance with this proposed SQMS.

6. The firm is responsible for designing, implementing, and operating the system of quality management. Under proposed SQMS *A Firm's System of Quality Management*, the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice,<sup>5</sup> which provides the firm with reasonable assurance that
  - the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements, and conduct engagements in accordance with such standards and requirements; and
  - engagement reports issued by the firm or engagement partners are appropriate in the circumstances.<sup>6</sup>
7. As explained in proposed SQMS *A Firm's System of Quality Management*, the public interest is served by the consistent performance of quality engagements. Quality engagements are achieved through planning and performing engagements and reporting on them in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and, when applicable to the type of engagement, ~~exercising~~ maintaining professional skepticism.
8. An engagement quality review is an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon. The engagement quality reviewer's evaluation of significant judgments is performed in the context of professional standards and applicable legal and regulatory requirements. However, an engagement quality review is not intended to be an evaluation of whether the entire engagement complies with professional standards and applicable legal and regulatory requirements or with the firm's policies or procedures.
9. The engagement quality reviewer is not a member of the engagement team. The performance of an engagement quality review does not change the responsibilities of the engagement partner for managing and achieving quality on the engagement or for the direction and supervision of the members of the engagement team and the review of their work. The engagement quality reviewer is not required to obtain evidence to support the opinion or conclusion on the engagement, but the engagement team may obtain further evidence in responding to matters raised during the engagement quality review.

Commented [AG1]: To be consistent with ASB style

#### Authority of This Proposed SQMS

10. This proposed SQMS contains the objective for the firm in following this proposed SQMS and requirements designed to enable the firm and the engagement quality reviewer to meet that stated objective. In addition, it contains related guidance in the form of application and

<sup>4</sup> Paragraph 35f of proposed SQMS *A Firm's System of Quality Management*.

<sup>5</sup> The term *auditing and accounting practice* is defined in paragraph 17a of proposed SQMS *A Firm's System of Quality Management*.

<sup>6</sup> Paragraph 15 of proposed SQMS *A Firm's System of Quality Management*.

other explanatory material and introductory material that provides context relevant to a proper understanding of this proposed SQMS and definitions. Proposed SQMS *A Firm's System of Quality Management*<sup>7</sup> explains the terms objective, requirements, application material and other explanatory material, introductory material, and definitions.

### Effective Date

11. This proposed SQMS is effective for
- audits or reviews of financial statements for periods beginning on or after [December 15, 2023~~5~~]\*, and
  - other engagements in the firm's accounting and auditing practice beginning on or after [December 15, ~~2023~~2025].\*

### Objective

12. The objective of the firm, through appointing an eligible engagement quality reviewer, is to perform an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon.

### Definitions

13. For purposes of the SQMSs, the following terms have the meanings attributed as follows:

**Engagement quality review.** An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed ~~on or~~ before the ~~date of the~~ engagement report is released.

**Engagement quality reviewer.** A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

**Relevant ethical requirements.** Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer, when undertaking an engagement quality review, are subject, which consist of the AICPA Code of Professional Conduct together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive. (Ref: par. A11–A14)

**Commented [AG2]:** To reflect ASB direction to retain extant requirements re: timing of EQR

### Requirements

#### Applying, and Complying With, Relevant Requirements

14. The firm and the engagement quality reviewer should have an understanding of this proposed SQMS, including the application and other explanatory material, to understand the objective of this SQMS and to properly apply the requirements relevant to them.

<sup>7</sup> Paragraph 12 and A6–A9 of proposed SQMS *A Firm's System of Quality Management*.

\* This date is provisional but will not be earlier than December 15, 2023.

\* This date is provisional but will not be earlier than December 15, 2023.

15. The firm or the engagement quality reviewer, as applicable, should comply with each requirement of this proposed SQMS, unless the requirement is not relevant in the circumstances of the engagement.
16. The proper application of the requirements is expected to provide a sufficient basis for the achievement of the objective of this proposed standard. However, if the firm or the engagement quality reviewer determines that the application of the relevant requirements does not provide a sufficient basis for the achievement of the objective of this proposed standard, the firm or the engagement quality reviewer, as applicable, should take further actions to achieve the objective.

#### Appointment and Eligibility of Engagement Quality Reviewers

17. The firm should establish policies or procedures that require the assignment of responsibility for the appointment of engagement quality reviewers to an individual or individuals with the competence, capabilities, and appropriate authority within the firm to fulfill the responsibility. Those policies or procedures should require such individual or individuals to appoint the engagement quality reviewer. (Ref: par. A1–A3)
18. The firm should establish policies or procedures that set forth the criteria for eligibility to be appointed as an engagement quality reviewer. Those policies or procedures should require that the engagement quality reviewer not be a member of the engagement team and (Ref: par. A4)
  - a. has the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review, (Ref: par. A5–A10)
  - b. complies with relevant ethical requirements, including those addressing threats to the objectivity and independence of the engagement quality reviewer, and (Ref: par. A11–A14)
  - c. complies with provisions of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer. (Ref: par. A15)
19. The firm’s policies or procedures established in accordance with paragraph 18b should also address threats to objectivity created by an individual being appointed as the engagement quality reviewer after previously serving as the engagement partner. Such policies or procedures should specify a cooling-off period of two years, or a longer period if required by relevant ethical requirements, before the engagement partner can assume the role of engagement quality reviewer. (Ref: par. A16–A17)
20. The firm should establish policies or procedures that set forth the criteria for eligibility of individuals who assist the engagement quality reviewer. Those policies or procedures should require that such individuals not be members of the engagement team and
  - a. have the competence and capabilities, including sufficient time, to perform the duties assigned to them, and (Ref: par. A18)
  - b. comply with relevant ethical requirements, including addressing threats to their objectivity and independence and, if applicable, the provisions of law and regulation. (Ref: par. A19–A20)

**Commented [AG3]:** To clarify it could be only one person; consistent with changes to other QM standards. See row 57, item 4D

**Commented [AG4]:** As directed by ASB.

21. The firm should establish policies or procedures that

- a. require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review, and
- b. address the engagement quality reviewer’s responsibility for determining the nature, timing, and extent of the direction and supervision of ~~the~~ individuals assisting in the engagement quality review and the review of their work. (Ref: par. A21)

***Impairment of the Engagement Quality Reviewer’s Eligibility to Perform the Engagement Quality Review***

22. The firm should establish policies or procedures that address circumstances in which the engagement quality reviewer’s eligibility to perform the engagement quality review is impaired and the appropriate actions to be taken by the firm, including the process for identifying and appointing a replacement in such circumstances. (Ref: par. A22)

23. When the engagement quality reviewer becomes aware of circumstances that impair the engagement quality reviewer’s eligibility, the engagement quality reviewer should notify the appropriate individual or individuals in the firm and (Ref: par. A23)

- a. if the engagement quality review has not commenced, decline the appointment to perform the engagement quality review, or
- b. if the engagement quality review has commenced, discontinue the performance of the engagement quality review.

**Performance of the Engagement Quality Review**

24. The firm should establish policies or procedures regarding the performance of the engagement quality review that address the following:

- a. The engagement quality reviewer’s responsibilities to perform procedures in accordance with paragraphs 25–26 at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon
- b. The responsibilities of the engagement partner in relation to the engagement quality review, including that the engagement partner is precluded from dating-releasing the engagement report until notification has been received from the engagement quality reviewer in accordance with paragraph 27 that the engagement quality review is complete (Ref: par. A24–A25)
- c. Circumstances when the nature and extent of engagement team discussions with the engagement quality reviewer about a significant judgment give rise to a threat to the objectivity of the engagement quality reviewer and appropriate actions to take in these circumstances (Ref: par. A26)

25. In performing the engagement quality review, the engagement quality reviewer should do the following: (Ref: par. A27–A32)

**Commented [JH5]:** It was a quick scan, but we flip between issue and release (or forms) between here and the QM SAS. Can we pick one or do we mean different things? I thought “report release date” was defined, so I was leaning towards release vs. issue. But could land on either if appropriately consistent.

**Commented [AG6]:** To remain consistent with extant.

- a. Read, and obtain an understanding about, information communicated by (Ref: par. A33)
  - i. the engagement team regarding the nature and circumstances of the engagement and the entity, and
  - ii. the firm related to the firm’s monitoring and remediation process, in particular, identified deficiencies that may relate to, or affect, the areas involving significant judgments made by the engagement team
- b. Discuss with the engagement partner and, if applicable, other members of the engagement team, significant matters and significant judgments made in planning, performing, and reporting on the engagement (Ref: par. A34–A37)
- c. Based on the information obtained in (a) and (b), review selected engagement documentation relating to ~~the significant judgments~~ made by the engagement team and evaluate the following: (Ref: par. A38–A42)
  - i. The basis for making those significant judgments, including, when applicable to the type of engagement, the ~~exercise~~ maintenance of professional skepticism by the engagement team
  - ii. Whether the engagement documentation supports the conclusions reached
  - iii. Whether the conclusions reached are appropriate
- d. Evaluate the basis for the engagement partner’s determination that relevant ethical requirements relating to independence, when applicable, have been fulfilled (Ref: par. A43)
- e. Evaluate whether appropriate consultation has taken place on difficult or contentious matters or matters involving differences of opinion and the conclusions arising from those consultations (Ref: par. A44)
- f. For ~~audits of financial statements~~ engagements conducted in accordance with generally accepted auditing standards, evaluate the basis for the engagement partner’s determination that the engagement partner’s involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. (Ref: par. A45–A46)

Commented [AG7]: To be consistent with b above,

Commented [AG8]: To be consistent with par. A46; see row 82, item 4D

g. Review

- i. for audits of financial statements, the financial statements and the auditor’s report thereon, including, if applicable, the description of the key audit matters; (Ref: par. A47)
- ii. for reviews of financial statements or financial information, the financial statements or financial information and the engagement review report thereon; or (Ref: par. A47)
- iii. for other engagements, the engagement report, and when applicable, the subject matter information. (Ref: par. A48)

**Commented [AG9]:** To be consistent with reference to auditor’s report in par. 25g(i) above.

26. The engagement quality reviewer should notify the engagement partner if the engagement quality reviewer has concerns that the significant judgments made by the engagement team, including the appropriate exercise maintenance of professional skepticism by the engagement team when applicable to the type of engagement, or the conclusions reached thereon, are not appropriate. If such concerns are not resolved to the engagement quality reviewer’s satisfaction, the engagement quality reviewer should notify the appropriate individual or individuals in the firm that the engagement quality review cannot be completed. (Ref: par. A49)

**Commented [AG10]:** See row 79, item 4D.

***Completion of the Engagement Quality Review***

27. The engagement quality reviewer should determine whether the requirements in this proposed SQMS with respect to the performance of the engagement quality review have been fulfilled and whether the engagement quality review is complete. If so, the engagement quality reviewer should notify the engagement partner that the engagement quality review is complete.

**Documentation**

28. The firm should establish policies or procedures that require the engagement quality reviewer to take responsibility for documentation of the engagement quality review. (Ref: par. A50)
29. The firm should establish policies or procedures that require documentation of the engagement quality review in accordance with paragraph 30 and that such documentation be included with the engagement documentation.
30. The engagement quality reviewer should determine that the documentation of the engagement quality review is sufficient to enable an experienced practitioner, having no previous connection with the engagement, to understand the nature, timing, and extent of the procedures performed by the engagement quality reviewer and, when applicable, individuals who assisted the reviewer, and the conclusions reached in performing the review. The engagement quality reviewer also should determine that the documentation of the engagement quality review includes the following: (Ref: par. A51–A53)
- a. The names of the engagement quality reviewer and any individuals who assisted with the engagement quality review
  - b. An identification of the engagement documentation reviewed

- c. The basis for the engagement quality reviewer’s determination in accordance with paragraph 27
- d. The notifications required in accordance with paragraphs 26 and 27
- e. The date of completion of the engagement quality review

## **Application and Other Explanatory Material**

### **Appointment and Eligibility of Engagement Quality Reviewers**

*Assignment of Responsibility for the Appointment of Engagement Quality Reviewers* (Ref: par. 17)

- A1. Competence and capabilities that are relevant to an individual’s ability to fulfill responsibility for the appointment of the engagement quality reviewer may include appropriate knowledge about the following:
  - The responsibilities of an engagement quality reviewer
  - The criteria in paragraphs 18–19 regarding the eligibility of engagement quality reviewers
  - The nature and circumstances of the engagement or the entity subject to an engagement quality review, including the composition of the engagement team
- A2. The firm’s policies or procedures may specify that the individual responsible for the appointment of engagement quality reviewers not be a member of the engagement team for which an engagement quality review is to be performed. However, in certain circumstances (for example, in the case of a smaller firm or a sole practitioner), it may not be practicable for an individual other than a member of the engagement team to appoint the engagement quality reviewer.
- A3. The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm’s policies or procedures may specify a different process for appointing engagement quality reviewers for audits of financial statements than for attestation examination engagements or other engagements, with different individuals responsible for each process.

*Eligibility of the Engagement Quality Reviewer* (Ref: par. 18)

- A4. In some circumstances, for example, in the case of a smaller firm or a sole practitioner, there may not be a partner or other individual in the firm who is eligible to perform the engagement quality review. In these circumstances, the firm may contract with, or obtain the services of, individuals external to the firm to perform the engagement quality review. An individual external to the firm may be a partner or an employee of a network firm, a structure or organization within the firm’s network, or a service provider. When using such an individual, the provisions in proposed SQMS *A Firm’s System of Quality Management* addressing network requirements or network services or service providers apply.

***Eligibility Criteria for the Engagement Quality Reviewer***

*Competence and Capabilities, Including Sufficient Time (Ref: par. 18a)*

- A5.** Proposed SQMS *A Firm's System of Quality Management* describes characteristics related to competence, including the integration and application of technical competence, professional skills, and professional ethics, values, and attitudes.<sup>8</sup> Matters that the firm may consider in determining that an individual has the necessary competence to perform an engagement quality review include, for example, the following:
- An understanding of professional standards and applicable legal and regulatory requirements and the firm's policies or procedures relevant to the engagement
  - Knowledge of the entity's industry
  - An understanding of, and experience relevant to, engagements of a similar nature and complexity
  - An understanding of the responsibilities of the engagement quality reviewer in performing and documenting the engagement quality review, which may be attained or enhanced by receiving relevant training from the firm
- A6.** The conditions, events, circumstances, actions, or inactions considered by the firm in determining that an engagement quality review is an appropriate response to address one or more quality risks<sup>9</sup> may be an important consideration in the firm's determination of the competence and capabilities required to perform the engagement quality review for that engagement. Other considerations that the firm may take into account in determining whether the engagement quality reviewer has the competence and capabilities, including sufficient time, needed to evaluate the significant judgments made by the engagement team and the conclusions reached thereon include, for example, the following:
- The nature of the entity.
  - The specialization and complexity of the industry or regulatory environment in which the entity operates.
  - The extent to which the engagement relates to matters requiring specialized expertise (for example, with respect to IT or specialized areas of accounting or auditing), or scientific and engineering expertise, which may be needed for certain assurance engagements. Also see paragraph A19.
- A7.** In evaluating the competence and capabilities of an individual who may be appointed as an engagement quality reviewer, the findings arising from the firm's monitoring activities (for example, findings from the inspection of engagements for which the individual was an engagement team member or engagement quality reviewer) or the results of external inspections may also be relevant considerations.

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<sup>8</sup> Paragraph [A89-A92](#) of proposed SQMS *A Firm's System of Quality Management*.

<sup>9</sup> See footnote 8.

- A8.** A lack of appropriate competence or capabilities affects the ability of the engagement quality reviewer to exercise appropriate professional judgment in performing the review. For example, an engagement quality reviewer who lacks relevant industry experience may not possess the ability or confidence necessary to evaluate and, when appropriate, challenge significant judgments made and the ~~exercise-maintenance~~ of professional skepticism, by the engagement team on a complex, industry-specific accounting or auditing matter.

*Appropriate Authority (Ref: par. 18a)*

- A9.** Actions at the firm level help to establish the authority of the engagement quality reviewer. For example, by creating a culture of respect for the role of the engagement quality reviewer, the engagement quality reviewer is less likely to experience pressure from the engagement partner or other personnel to inappropriately influence the outcome of the engagement quality review. In some cases, the engagement quality reviewer's authority may be enhanced by the firm's policies or procedures to address differences of opinion, which may include actions the engagement quality reviewer may take when a disagreement occurs between the engagement quality reviewer and the engagement team.
- A10.** The authority of the engagement quality reviewer may be diminished when
- the culture within the firm promotes respect for authority only for personnel at a higher level of hierarchy within the firm.
  - the engagement quality reviewer has a reporting line to the engagement partner, for example, when the engagement partner holds a leadership position in the firm or is responsible for determining the compensation of the engagement quality reviewer.

*Relevant Ethical Requirements (Ref: par. 13c and 18b)*

- A11.** The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of the engagement or the entity. ~~Various provisions of relevant ethical requirements may include various provisions, such as specific independence requirements, that~~ apply to ~~an~~ individuals, such as an engagement quality reviewer, and not the firm ~~itself~~. For example, if a firm uses an external provider to perform an engagement quality review, that individual may be subject to independence requirements; ~~however, the independence requirements imposed on that individual as a result of performing the engagement quality review may not extend to,~~ but the entire firm for ~~whom which the that~~ individual works ~~may not need to comply with independence requirements related to the entity.~~
- A12.** Relevant ethical requirements may also include provisions that address threats to independence created by long association with an audit or assurance client. The application of any such provisions dealing with long association is distinct from, but may need to be taken into consideration in applying, the required cooling-off period in accordance with paragraph 19.

Commented [JH11]: Deleted extraneous "t"

Commented [AG12]: See row 96, item 4D

*Threats to the Objectivity of the Engagement Quality Reviewer*

- A13.** Threats to the engagement quality reviewer's objectivity may be created by a broad range of facts and circumstances. Examples follow:

- A self-review threat may be created when the engagement quality reviewer previously was involved with significant judgments made by the engagement team, in particular, as the engagement partner or other engagement team member.
- A familiarity or self-interest threat may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team.
- An intimidation threat may be created when actual or perceived pressure is exerted on the engagement quality reviewer (for example, when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner).

**A14.** Relevant ethical requirements may include requirements and guidance to identify, evaluate, and address threats to objectivity.

*Law or Regulation Relevant to the Eligibility of the Engagement Quality Reviewer (Ref: par 18c)*

**A15.** Law or regulation may prescribe additional requirements regarding the eligibility of the engagement quality reviewer. For example, the audit requirements of the FDIC regulations for certain financial institutions require the auditor (which includes the engagement quality reviewer) to be in compliance with the AICPA's Code of Professional Conduct and also meet the independence requirements and interpretations of the SEC and its staff.

*Cooling-Off Period for an Individual After Previously Serving as the Engagement Partner (Ref: par. 19)*

**A16.** In recurring engagements, the matters on which significant judgments are made often do not vary. Therefore, significant judgments made in prior periods may continue to affect judgments of the engagement team in subsequent periods. Therefore, the ability of an engagement quality reviewer to perform an objective evaluation of significant judgments is affected when the individual was previously involved with those judgments as the engagement partner. In such circumstances, it is important that appropriate safeguards are put in place to reduce threats to objectivity, in particular, the self-review threat, to an acceptable level. Accordingly, this proposed SQMS requires the firm to establish policies or procedures that specify a cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. The following factors may be taken into consideration when designing policies and procedures to maintain the objectivity of an engagement quality reviewer who served as the engagement partner on the previous year's engagement:

- The extent of changes in the matters on which significant judgments are made and the facts and circumstances around those significant judgments compared to the period(s) in which the individual was the engagement partner. For example, if a new accounting pronouncement has been implemented, the significant judgments made in the current period may vary from those of the prior period to

such an extent that an objective evaluation of those judgments could be made by the individual who served as the engagement partner in the previous period.

- The procedures and incentives placed by the firm’s system of quality management on objective reviews (for example, the engagement quality reviewer would not be penalized for identifying a misstatement related to a year in which the reviewer was the engagement partner)

**A16A**-A firm may establish policies or procedures that limit the eligibility of individuals to be appointed as engagement quality reviewers who previously served as the engagement partner, for example, by establishing a specified cooling-off period during which the engagement partner is precluded from being appointed as the engagement quality reviewer. Determining a suitable cooling-off period depends upon the facts and circumstances of the engagement.

**Commented [AG13]:** As directed by ASB

**A17.** The firm’s policies or procedures also may address whether a cooling-off period is appropriate for an individual other than the engagement partner before becoming eligible to be appointed as the engagement quality reviewer on that engagement. In this regard, the firm may consider the nature of that individual’s role and previous involvement with the significant judgments made on the engagement. For example, the firm may determine that an engagement partner responsible for the performance of audit procedures on the financial information of a component in a group audit engagement may not be eligible to be appointed as the group engagement quality reviewer because of that audit partner’s involvement in the significant judgments affecting the group audit engagement.

*Circumstances in Which the Engagement Quality Reviewer Uses Assistants (Ref: par. 20–21)*

**A18.** In certain circumstances, it may be appropriate for the engagement quality reviewer to be assisted by an individual or team of individuals ~~with the relevant expertise~~. For example, ~~assistance from individuals with~~ highly specialized knowledge, skills, or expertise may be useful for understanding certain transactions undertaken by the entity to help the engagement quality reviewer evaluate the significant judgments made by the engagement team related to those transactions.

**Commented [AG14]:** See row 63, agenda item 4D. To avoid implication that assistance is only appropriate when specialized knowledge is needed.

**A19.** The guidance in paragraph A14 may be helpful to the firm when establishing policies or procedures that address threats to objectivity of individuals who assist the engagement quality reviewer.

**A20.** When the engagement quality reviewer is assisted by an individual external to the firm, the assistant’s responsibilities, including those related to compliance with relevant ethical requirements, may be set out in the contract or other agreement between the firm and the assistant.

**A21.** The firm’s policies or procedures may include responsibilities of the engagement quality reviewer to

- consider whether assistants understand their instructions and whether the work is being carried out in accordance with the planned approach to the engagement quality review, and
- address matters raised by assistants, considering their significance and modifying the planned approach appropriately.

*Impairment of the Engagement Quality Reviewer’s Eligibility to Perform the Engagement Quality Review* (Ref: par. 22–23)

- A22.** Factors that may be relevant to the firm in considering whether the eligibility of the engagement quality reviewer to perform the engagement quality review is impaired include the following:
- Whether changes in the circumstances of the engagement result in the engagement quality reviewer no longer having the appropriate competence and capabilities to perform the review
  - Whether changes in the other responsibilities of the engagement quality reviewer indicate that the individual no longer has sufficient time to perform the review
  - Notification from the engagement quality reviewer in accordance with paragraph 23
- A23.** In circumstances in which the engagement quality reviewer’s eligibility to perform the engagement quality review becomes impaired, the firm’s policies or procedures may set out a process by which alternative eligible individuals are identified. The firm’s policies or procedures may also address the responsibility of the individual appointed to replace the engagement quality reviewer to perform procedures sufficient to fulfill the requirements of this proposed SQMS with respect to the performance of the engagement quality review. Such policies or procedures may further address the need for consultation in such circumstances and may include, for example, the following:
- Evaluation of whether ~~any review work that has been~~ procedures performed by the previous engagement quality reviewer could be relied upon by the newly assigned engagement quality reviewer or whether all work would need to be reperformed
  - Consideration of the effect of an engagement quality review assistant on the transition, when such assistant has been involved in the engagement quality review prior to transition
  - Procedures undertaken by the engagement team to inform the newly assigned engagement quality reviewer about planning meeting discussions that have already occurred and other matters in which the previous engagement quality reviewer had been involved
  - Documentation of the circumstances necessitating the change

**Commented [AG15]:** See row 101, item 4D. More precise word.

**Performance of the Engagement Quality Review** (Ref: par. 24–27)

*Engagement Partner Responsibilities in Relation to the Engagement Quality Review* (Ref: par. 24b)

- A24.** Proposed Statement on Auditing Standards (SAS) *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*<sup>10</sup> establishes the requirements for the engagement partner in audit engagements for which an engagement quality review is required, including

<sup>10</sup> Paragraph 36 of proposed Statement on Auditing Standards (SAS) *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*.

- determining that an engagement quality reviewer has been appointed;
- cooperating with the engagement quality reviewer and informing other members of the engagement team of their responsibility to do so;
- discussing significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer; and
- ~~not dating-releasing~~ the auditor's report until the completion of the engagement quality review.

Commented [JH16]: Release/issue?

**A24A.** If the engagement quality review is completed after the report is dated and identifies instances where additional procedures are needed or additional evidence is required, the date of the report is changed to the date when the additional procedures have been satisfactorily completed or the additional evidence has been obtained, in accordance with the professional standards applicable to the engagement. Such instances may be indicative of a deficiency or deficiencies in the firm's system of quality management.

Commented [AG17]: From extant QC10.A43. Last sentence is new.

**A25.** AUAT-C section 105, *Concepts Common to All Attestation Engagements*,<sup>11,\*</sup> also establishes requirements for the engagement partner in relation to the engagement quality review.

**Discussions Between the Engagement Quality Reviewer and the Engagement Team** (Ref: par. 24c)

**A26.** Frequent communication between the engagement team and engagement quality reviewer throughout the engagement may assist in facilitating an effective and timely engagement quality review. However, a threat to the objectivity of the engagement quality reviewer may be created depending on the timing and extent of the discussions with the engagement team about a significant judgment. The firm's policies or procedures may set out the actions to be taken by the engagement quality reviewer or the engagement team to avoid situations in which the engagement quality reviewer is, or may be perceived to be, making decisions on behalf of the engagement team. For example, in these circumstances, the firm may require consultation about such significant judgments with other relevant personnel in accordance with the firm's consultation policies or procedures.

**Procedures Performed by the Engagement Quality Reviewer** (Ref: par. 25–27)

**A27.** The firm's policies or procedures may specify the nature, timing, and extent of the procedures performed by the engagement quality reviewer and also may emphasize the importance of the engagement quality reviewer exercising professional judgment in performing the review.

**A28.** The timing of the procedures performed by the engagement quality reviewer may depend on the nature and circumstances of the engagement or the entity, including the nature of the matters subject to the review. Timely review of the engagement documentation by the

<sup>11</sup> Paragraph 36 of International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*.

\* All AU-C sections can be found in AICPA *Professional Standards*.

engagement quality reviewer throughout all stages of the engagement (for example, planning, performing, and reporting) allows matters to be promptly resolved to the engagement quality reviewer's satisfaction ~~on or~~ before the ~~date-release~~ of the engagement report. For example, the engagement quality reviewer may perform procedures in relation to the overall strategy and plan for the engagement at the completion of the planning phase. Timely performance of the engagement quality review also may reinforce the exercise of professional judgment and, when applicable to the type of engagement, maintenance of professional skepticism, by the engagement team in planning and performing the engagement.

Commented [AG18]: To remain consistent with extant

**A29.** The nature and extent of the engagement quality reviewer's procedures for a specific engagement may depend on the following, among other factors:

- The reasons for the assessments given to quality risks,<sup>12</sup> for example, engagements performed for entities in emerging industries or with complex transactions.
- Identified deficiencies, and the remedial actions to address the identified deficiencies, related to the firm's monitoring and remediation process, and any related guidance issued by the firm, which may indicate areas where more extensive procedures need to be performed by the engagement quality reviewer.
- The complexity of the engagement.
- The nature and size of the entity, including whether the entity is a listed entity.
- Findings relevant to the engagement, such as the results of inspections undertaken by an external oversight authority in a prior period, or other concerns raised about the quality of the work of the engagement team.
- Information obtained from the firm's acceptance and continuance of client relationships and specific engagements.
- For assurance engagements, the engagement team's identification and assessment of, and responses to, risks of material misstatement in the engagement.
- Whether members of the engagement team have cooperated with the engagement quality reviewer. The firm's policies or procedures may address the actions the engagement quality reviewer takes in circumstances when the engagement team has not cooperated with the engagement quality reviewer, for example, informing an appropriate individual in the firm so appropriate action can be taken to resolve the issue.

**A30.** The nature, timing, and extent of the engagement quality reviewer's procedures may need to change based on circumstances encountered in performing the engagement quality review.

#### *Group Audit Considerations*

**A31.** The performance of an engagement quality review for an audit of group financial statements may involve additional considerations for the individual appointed as the engagement quality

<sup>12</sup> Paragraph A49 of proposed SQMS *A Firm's System of Quality Management*.

reviewer for the group audit, depending on the size and complexity of the group. Paragraph 21a requires the firm's policies or procedures to require the engagement quality reviewer to take overall responsibility for the performance of the engagement quality review. In doing so, for larger and more complex group audits, the group engagement quality reviewer may need to discuss significant matters and significant judgments with key members of the engagement team other than the group engagement team (for example, those responsible for performing audit procedures on the financial information of a component). In these circumstances, the engagement quality reviewer may be assisted by individuals in accordance with paragraph 20. The guidance in paragraph A22 may be helpful when the engagement quality reviewer for the group audit is using assistants.

- A32.** In some cases, an engagement quality reviewer may be appointed for an audit of an entity or business unit that is part of a group, for example, when such an audit is required by law, regulation, or other reasons. In these circumstances, communication between the engagement quality reviewer for the group audit and the engagement quality reviewer for the audit of that entity or business unit may help the group engagement quality reviewer in fulfilling the responsibilities in accordance with paragraph 21a. For example, this may be the case when the entity or business unit has been identified as a component for purposes of the group audit and significant judgments related to the group audit have been made at the component level.

*Information Communicated by the Engagement Team and the Firm (Ref: par. 25a)*

- A33.** Obtaining an understanding of information communicated by the engagement team and the firm in accordance with paragraph 25a may assist the engagement quality reviewer in understanding the significant judgments that may be expected for the engagement. Such an understanding may also provide the engagement quality reviewer with a basis for discussions with the engagement team about the significant matters and significant judgments made in planning, performing, and reporting on the engagement. For example, a deficiency identified by the firm may relate to significant judgments made by other engagement teams for certain accounting estimates for a particular industry. When this is the case, such information may be relevant to the significant judgments made on the engagement with respect to those accounting estimates and, therefore, may provide the engagement quality reviewer with a basis for discussions with the engagement team in accordance with paragraph 25b.

*Significant Matters and Significant Judgments (Ref: par. 25b–c)*

- A34.** For audits of financial statements, proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*<sup>13</sup> requires the engagement partner to review audit documentation relating to significant matters<sup>14</sup> and significant judgments, including those relating to difficult or contentious matters identified during the engagement, and the conclusions reached.

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<sup>13</sup> Paragraph 31 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

<sup>14</sup> Paragraph 8c of AU-C section 230, *Audit Documentation*.

- A35.** For audits of financial statements, proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*<sup>15</sup> provides examples of significant judgments that may be identified by the engagement partner related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team.
- A36.** For engagements other than audits of financial statements, the significant judgments made by the engagement team may depend on the nature and circumstances of the engagement or the entity. For example, in an attestation engagement performed in accordance with Statements on Standards for Attestation Engagements, the engagement team’s determination of whether the criteria to be applied in the preparation of the subject matter information are suitable for the engagement may involve or require significant judgment.
- A37.** In performing the engagement quality review, the engagement quality reviewer may become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team’s procedures performed or the basis for conclusions reached. In those circumstances, discussions with the engagement quality reviewer may result in the engagement team concluding that additional procedures need to be performed.
- A38.** The information obtained in accordance with paragraphs 25a–b, and the review of selected documentation, assists the engagement quality reviewer in evaluating the engagement team’s basis for making the significant judgments. Other considerations that may be relevant to the engagement quality reviewer’s evaluation include, for example, the following:
- Remaining alert to changes in the nature and circumstances of the engagement or the entity that may result in changes in the significant judgments made by the engagement team
  - Applying an unbiased view in evaluating responses from the engagement team
  - Following up on inconsistencies identified in reviewing engagement documentation or inconsistent responses by the engagement team to questions relating to the significant judgments made
- A39.** The firm’s policies or procedures may specify engagement documentation to be reviewed by the engagement quality reviewer. In addition, such policies or procedures may indicate that the engagement quality reviewer exercises professional judgment in selecting additional engagement documentation to be reviewed relating to significant judgments made by the engagement team.
- A40.** Discussions about significant judgments with the engagement partner and, if applicable, other members of the engagement team, together with the engagement team’s documentation, may assist the engagement quality reviewer in evaluating the ~~exercise~~ maintenance of professional skepticism, when applicable to the engagement, by the engagement team in relation to those significant judgments.

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<sup>15</sup> Paragraph A92 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

- A41.** For audits of financial statements, proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*<sup>16</sup> provides examples of the impediments to the ~~exercise~~-maintenance of professional skepticism at the engagement level, unconscious auditor biases that may impede the maintenance ~~exercise~~ of professional skepticism, and possible actions that the engagement team may take to mitigate impediments to the maintenance ~~exercise~~ of professional skepticism at the engagement level.
- A42.** For audits of financial statements, the requirements and relevant application material in proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*;<sup>17</sup> AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*;<sup>18</sup> and other AU-C sections also provide examples of areas in an audit where the auditor ~~exercises~~-maintains professional skepticism or examples of where appropriate documentation may help provide evidence about how the auditor ~~exercised~~-maintained professional skepticism. Such guidance may also assist the engagement quality reviewer in evaluating the ~~exercise~~-maintenance of professional skepticism by the engagement team.

*Whether Relevant Ethical Requirements Relating to Independence Have Been Fulfilled (Ref: par. 25d)*

- A43.** Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*<sup>19</sup> requires the engagement partner, prior to dating the auditor's report, to take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled.

*Whether Consultation Has Taken Place on Difficult or Contentious Matters or Matters Involving Differences of Opinion (Ref: par. 25e)*

- A44.** Proposed SQMS *A Firm's System of Quality Management*<sup>20</sup> addresses consultation on difficult or contentious matters and differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management.

*Sufficient and Appropriate Involvement of the Engagement Partner on the Engagement (Ref: par. 25f)*

- A45.** Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards*<sup>21</sup> requires the engagement partner to determine,

<sup>16</sup> Paragraphs A33–A35 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

<sup>17</sup> Paragraph A255 of proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

<sup>18</sup> Paragraph .A11 of AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*.

<sup>19</sup> Paragraph 21 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

<sup>20</sup> Paragraphs 32d–e and A80–A83 of proposed SQMS *A Firm's System of Quality Management*.

<sup>21</sup> Paragraph 40a of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

prior to dating the auditor’s report, that the engagement partner’s involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement. Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards* <sup>22</sup> also indicates that the documentation of the involvement of the engagement partner may be accomplished in different ways. Discussions with the engagement team, and review of such engagement documentation, may assist the engagement quality reviewer’s evaluation of the basis for the engagement partner’s determination that the engagement partner’s involvement has been sufficient and appropriate.

- A46.** Proposed SAS *Quality Management for an Engagement Performed in Accordance With Generally Accepted Auditing Standards* is adapted, as necessary, to engagements performed in accordance with generally accepted auditing standards other than audits of financial statements. Accordingly, the requirement in paragraph 25f ~~may also be applied is applicable, as necessary,~~ to those engagements.

**Commented [AG19]:** To clarify.

**Engagement Quality Reviewer’s** Review of Financial Statements and Engagement Reports (Ref: par. 25g)

**Commented [AG20]:** To clarify what “review” refers to

- A47.** For audits of financial statements, the engagement quality reviewer’s review of the financial statements and auditor’s report thereon is consistent with the engagement quality reviewer’s understanding of those matters based on the review of selected engagement documentation and discussions with the engagement team. In reviewing the financial statements, the engagement quality reviewer may also become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team’s procedures or conclusions. The guidance in this paragraph also applies to ~~reviews of financial statements engagements~~ and the related engagement report.

- A48.** For engagements other than audits ~~or reviews~~ of financial statements, the engagement quality reviewer’s review of the engagement report and, when applicable, the subject matter information may include considerations similar to those described in paragraph ~~A46 A45~~ (for example, whether the presentation or description of matters relating to the significant judgments made by the engagement team are consistent with the engagement quality reviewer’s understanding based on the procedures performed in connection with the ~~engagement quality~~ review).

**Commented [AG21]:** See row 103, item 4D. To distinguish between reviews under SSARs and under SSAEs.

Unresolved Concerns of the Engagement Quality Reviewer (Ref: par. 26)

- A49.** The firm’s policies or procedures may specify the ~~individual or~~ individuals in the firm to be notified if the engagement quality reviewer has unresolved concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate. Such individuals may include the individual assigned the responsibility for the

<sup>22</sup> Paragraph A118 of proposed SAS *Quality Management for An Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

appointment of engagement quality reviewers. With respect to such unresolved concerns, the firm's policies or procedures may also require consultation within or outside the firm (for example, a professional or regulatory body).

**Documentation** (Ref: par. 28–30)

- A50.** Paragraphs 58–61 of proposed SQMS *A Firm's System of Quality Management* address the firm's documentation of its system of quality management, which includes the firm's policies and procedures addressing engagements that are required to be subject to engagement quality reviews. This proposed SQMS addresses additional documentation requirements related to such policies and procedures as well as documentation requirements related to the performance of engagement quality reviews undertaken at the engagement level.
- A51.** The form, content, and extent of the documentation of the engagement quality review may depend on the following factors:
- The nature and complexity of the engagement
  - The nature of the entity
  - The nature and complexity of the matters subject to the engagement quality review
  - The extent of the engagement documentation reviewed
- A52.** The performance and notification of the completion of the engagement quality review may be documented in a number of ways. For example, the engagement quality reviewer may document the review of engagement documentation electronically in the IT application for the performance of the engagement. Alternatively, the engagement quality reviewer may document the review through means of a memorandum. The engagement quality reviewer's procedures may also be documented in other ways, for example, in the minutes of the engagement team's discussions when the engagement quality reviewer was present.
- A53.** Paragraph 24b requires that the firm's policies or procedures preclude the engagement partner from ~~dating-releasing~~ the engagement report until the completion of the engagement quality review, which includes resolving matters raised by the engagement quality reviewer. Provided that all requirements with respect to the performance of the engagement quality review have been fulfilled, the documentation of the review may be finalized after the ~~date-release~~ of the engagement report but before the assembly of the final engagement file.



**QM 2 Detailed Comments<sup>1</sup>**

Responses relating to potential changes in the proposed standard are addressed in the Comments column. Some responses in this analysis refer to the cooling-off period (generally because these references are at a high level and another section of the respondent’s letter addressed cooling-off in more specificity). Because the ASB addressed the issue of cooling-off at its October meeting, those comments are not addressed herein.

Row	CL #	Category	Coded Text	Task Force Comments
1	06	QM2 Overall\ 1 Strongly support	We strongly support the majority of the new SQMs	Noted
2	65	QM2 Overall\ 1 Strongly support	X I strongly support the proposed SQMS No. 2.	Noted
3	77	QM2 Overall\ 1 Strongly support	<p>We recognize the significant role an engagement quality review has within the system of quality management. We concur that a firm should set forth its requirements for when an engagement quality review is required and that criteria should be established regarding who can appoint reviewers and who can be appointed as reviewers. The requirements for engagement quality reviewers to comply with ethical requirements, including addressing threats to objectivity like not allowing previous engagement partners to become engagement quality reviewers without a cooling off period, are all reasonable.</p> <p>We concur with engagement quality reviewers focusing on significant judgments and significant matters, with the engagement partner continuing to be responsible for the matters described in proposed QM SAS (see response to Request for comment 4). As with all engagement procedures, including engagement quality reviews, the timeliness of the procedures and the documentation assembled lead to improved quality.</p>	Noted

<sup>1</sup> List of CL respondents was provided as agenda item 4A in the materials for the October ASB meeting (<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/asb/downloadabledocuments/202110-asb-item4a.pdf>)

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Row	CL #	Category	Coded Text	Task Force Comments
4	81	QM2 Overall\ 1 Strongly support	We support the proposed QM SAS and believe the requirements regarding engagement partner responsibilities are generally clear and understandable and that the application material is helpful in supporting the implementation of the requirements.	Noted
5	92	QM2 Overall\ 1 Strongly support	We strongly support the proposed QM SAS.	Noted
6	92	QM2 Overall\ 1 Strongly support	We strongly support the proposed SQMS No. 2.	Noted
7	102	QM2 Overall\ 1 Strongly support	The Committee has no issues with QM SAS. The proposal strengthens engagement performance which the Committee believes is a positive approach. The Committee recommends that QM SAS be accepted as presented.	Noted
8	143	QM2 Overall\ 1 Strongly support	D&T is supportive of a separate standard for engagement quality reviews and believes that such an approach appropriately emphasizes the important role of engagement quality reviews as part of a firm’s SOQM. As an engagement quality review is a response to assessed quality risks, D&T agrees that proposed SQMS No. 1 should identify the engagements for which an engagement quality review is to be performed, with proposed SQMS No. 2 containing the requirements and related guidance for performance of an engagement quality review. In addition, a separate standard provides an appropriate mechanism for enhancing the requirements and application material for the appointment and eligibility of the engagement quality reviewer and the performance and documentation of the review while increasing the scalability of proposed SQMS No. 1.	Noted
9	143	QM2 Overall\ 1 Strongly support	D&T is supportive of enhancing the extant requirements and related application material regarding the nature, timing, and extent of the procedures performed by the engagement quality reviewer. In addition, we believe the responsibilities of the engagement quality reviewer are appropriate considering the engagement partner’s revised responsibilities in proposed QM SAS. D&T is supportive of the focus on documentation of the engagement quality review, including the new requirement that such documentation be included with the engagement documentation. Further, from a scalability perspective, we support the application material, which recognizes that the engagement quality review may be documented in a number of ways and that the form, content, and extent of such documentation may vary according to the nature and complexity of the engagement, the entity, and matters subject to review, as well as the extent of engagement documentation reviewed.	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			D&T believes the requirements are clear and understandable and the application material is helpful.	
10	158	QM2 Overall\ 1 Strongly support	We strongly support the proposed SQMS No. 2 and its requirements are clear and understandable. The application material in the proposed SQMS No. 2 is helpful in supporting the requirements.	Noted
11	159	QM2 Overall\ 1 Strongly support	I strongly support the proposed SQMS No. 2.	Noted
12	161	QM2 Overall\ 1 Strongly support	We support a separate standard for engagement quality reviews (EQRs). We believe that it is useful to bring together the requirements for the firm and the reviewer into a single standard, and more clearly articulate the nature and extent of work expected of an engagement quality reviewer.	Noted
13	55	QM2 Overall\ 2 Somewhat support	The Committee somewhat supports the proposed SQMS No. 2. The Committee believes the Engagement Quality Reviews (EQR) requirements are clear and understandable in their content. There is significantly better clarity. For instance, an EQR can be a response to quality risks for any type of engagement, not only an audit engagement. Moreover, the guidance is more robust in the proposed standard. We appreciate the ASB's guidance related to the performance of the EQR requiring the reviewer to focus his/her attention on the engagement's significant judgments and significant matters, and also on getting the EQR completed throughout the engagement at different points in time. This will result in potential engagement issues being detected more timely and the review can be more effective. In addition, the requirement for the reviewer to take responsibility for the review and to file the documentation of the review along with the engagement documentation would also help to enhance engagement quality. However, some of the Committee members expressed concerns about a potential adverse effect from the EQR requirements about the appointment and eligibility of reviewers. The limitations in the eligibility of the reviewers seem to be very restrictive, and, especially in combination with the 2-year cooling-off period, smaller firms may look to circumvent the use of EQR to avoid the issue of engagement partner rotation or having to hire a reviewer outside of the firm. It would be preferable to utilize a risk-based approach and emphasize that firms meet the ethical requirements as contained in the proposed standard, rather than rely on a pre-determined cooling-off period.	Noted
14	61	QM2 Overall\ 	CRI agrees that the proposed SQMS No. 2 has clarified the role and responsibilities of the engagement quality reviewer from the existing guidance in QC Section 10, A Firm's System of	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
		2 Somewhat support	Quality Control, and AU-C Section 2020, Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards; that the application material is helpful in supporting the application of those responsibilities; and with the changes outlined in proposed SQMS No. 2, with the exception of the following items:  Cooling-off period as addressed in paragraph 19 – see response to question 8	
15	69	QM2 Overall\ 2 Somewhat support	We believe it is beneficial to have the Engagement Quality Review guidance in a separate standard. We believe the requirements are consistent with the existing literature and will provide appropriate guidance to firms in implementing this process. One could make the argument to make a more standard uniform across all firms, that every firm would need to seek an outside quality control reviewer to keep the impacts of the new standard fair across all firm types and sizes	Noted
16	81	QM2 Overall\ 2 Somewhat support	We somewhat support the proposed SQMS No. 2 and believe the requirements are generally clear and understandable and that the application material is helpful in supporting the implementation of the requirements.	Noted
17	100	QM2 Overall\ 2 Somewhat support	Consistent with our responses throughout this letter, TIC somewhat supports SQMS No. 2. TIC is concerned that the SQMS places too much emphasis on establishing rules for which individuals are eligible to serve as engagement quality reviewers (EQRs) with respect to the cooling-off period. By limiting which individuals may serve as an EQR, TIC believes that some firms may change their criteria for which engagements require an EQR. This scenario could result in less engagements being subject to EQR procedures. Alternatively, some firms may assign a reviewer who is not qualified to perform the EQR. Neither of these scenarios would enhance quality.	Noted
18	102	QM2 Overall\ 2 Somewhat support	Somewhat support the proposed SQMS No. 2.	Noted
19	134	QM2 Overall\ 2 Somewhat support	Separate standard We support creating a separate standard for engagement quality (EQ) reviews as well as retaining the requirement in SQMS 1 for the firm to develop policies or procedures for engagements involving an EQ review. We believe that this approach promotes the scalability of the standards, so that when a firm determines that no engagement meets the criteria to require an EQ review, it is not required to address the requirements in SQMS 2. We further support the proposed standard addressing the remaining aspects of the firm's	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			system of quality management related to EQ reviews. By accumulating all the requirements relating to EQ reviews in a single and separate location, there is less opportunity for a requirement to be overlooked. Additional explanation and guidance can be provided without affecting the length and complexity of SQMS 1 or distorting the balance of EQ reviews relative to the other aspects of SQMS 1.	
20	138	QM2 Overall\ 2 Somewhat support	Implementation of the proposed standard should achieve the objective of consistent performance of quality engagements. While the proposed standard is very comprehensive, we believe it can be implemented in a way that is scalable based on the characteristics of a firm’s assurance practice. We support the proposal, however, the change from QC Section 10 to require the engagement quality review to be completed prior to dating the report may result in added complexity to end of engagement coordination to obtain management representation letters and certain other documentation, without commensurate benefit. We suggest allowing the use of judgment by the engagement quality reviewer to consider the extent and significance of engagement quality review matters that remain open in determining when to provide the engagement partner with the approval to date the report.	Noted
21	138	QM2 Overall\ 2 Somewhat support	We somewhat support the proposed SQMS No. 2	Noted
22	139	QM2 Overall\ 2 Somewhat support	We support the notion of an Engagement Quality Review based on appropriate criteria established by the firm. However, there are certain aspects of the performance requirements that we believe need to be clarified.	Noted
23	144	QM2 Overall\ 2 Somewhat support	I somewhat support the proposed SQMS No. 2. This should not be a big change from current practice for my firm. However, I want to state that by mandating a cooling-off period, you are taking someone with great understanding of significant estimates on an engagement and removing them and their knowledge/experience from the equation. This seems contrary to quality and may put an undue hardship on firms to seek outside EQRs, which are more difficult to manage and are costlier to obtain. Similarly, by making the EQR eligibility requirements more robust, there may be fewer EQR options inside a firm, especially when eliminating a former engagement partner, which will lead to less use of the EQR as a tool in addressing firm quality.	Noted
24	156	QM2 Overall\ 2 Somewhat support	I support the proposed SQMS No. 2.	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
25	161	QM2 Overall\ 2 Somewhat support	Engagement quality reviews (EQRs) are an important response by a firm in managing and achieving quality. We support a separate standard for EQRs and the proposal to converge with ISQM 2. We believe that it is useful to bring together the requirements for the firm and the reviewer into a single standard, and more clearly articulate the nature and extent of work expected of an engagement quality reviewer. We support the majority of the proposed revised requirements, and note these revisions appear consistent with the intent of PCAOB AS 1220. In general, we believe the proposed requirements in proposed SQMS No. 2 are clear and understandable, and the application material is helpful in supporting the application of those requirements; however, we have some concerns about perceptions of what an EQR can realistically achieve, as well as the interaction with other standard-setting projects. See also our response to Questions 8 and 9.	Noted
26	162	QM2 Overall\ 2 Somewhat support	somewhat support the proposed SQMS No. 2.	Noted
27	163	QM2 Overall\ 2 Somewhat support	We believe it is beneficial to have the Engagement Quality Review guidance in a separate standard. We believe the proposed requirements may not be affordable or achievable by small firms. Small firms who are required to utilize the services of an outside review may be prohibited to continue their work due to time availability of resources long term and cost restraints.	Noted
28	164	QM2 Overall\ 2 Somewhat support	We somewhat support the proposed SQMS No. 2.	Noted
29	168	QM2 Overall\ 2 Somewhat support	I somewhat support the proposed SQMS No	Noted
30	130	QM2 Overall\ 3 Somewhat oppose	We are somewhat opposed to the proposed SQMS No. 2	Noted
31	132	QM2 Overall\ 3 Somewhat oppose	While it is definitely appropriate and necessary to stipulate the responsibilities of all parties in conjunction with the quality performance of the engagement in the public interest, the framework conveyed both devalues and borderline prohibits smaller CPA firms with regards to the providing attest engagements.	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			Accordingly, with regards to the eligibility or reviewers/ECRs/engagement inspectors, I am, at best, somewhat opposed as they are written.	
32	146	QM2 Overall\ 3 Somewhat oppose	We somewhat oppose the proposed SQMS No. 2.	Noted
33	167	QM2 Overall\ 3 Somewhat oppose	We agree with the nature of the changes outlined in this section. However, we do not believe that this is scalable, affordable, or practical for many smaller firms.	Noted
34	76	QM2 Overall\ 4 Strongly oppose	KI I strongly oppose the proposed SQMS No. 2.	Noted
35	79	QM2 Overall\ 4 Strongly oppose	I strongly oppose the proposed SQMS No. 2.	Noted
36	94	QM2 Overall\ 4 Strongly oppose	Proposed SQM No. 2: Similar challenges are inherent with the requirements for policies and procedures in SQM No. 2. Implementing processes to comply with the proposed standard will be costly in that firms may need to employ the services of an external engagement quality reviewer and may need to make an investment in systems and services in order to comply.	Noted
37	65	QM2 Overall\ Specific comments	An engagement quality review is a critical element in addressing quality risks by subjecting significant engagement matters and judgments to an independent critical review. My former firm has extensive policies and procedures in place for: (a) addressing the appointment, eligibility and rotation (i.e., limits on how long an individual can serve as a reviewer on an engagement) of engagement quality reviewers and (b) performing engagement quality reviews. Also, at my former firm an engagement quality review was performed for all audit and assurance engagements.	Noted
38	69	QM2 Overall\ Specific comments	We believe the proposed requirements may not be affordable or achievable by small firms. Typically, firms rely upon qualified professionals to perform EQCRs outside the firm. Firms currently utilize peer reviewers who are qualified to perform EQCRs. Because the peer reviewer pool is shrinking, it is challenging for a firm to locate a qualified individual to perform an EQCR. Small firms who are required to utilize the services of an outside review may be prohibited to continue their work due to cost restraints.	Noted
39	71	QM2 Overall\ Specific comments	The Group believes the scalability of proposed No. 1 would be increased - by not including requirements that would not be relevant in circumstances when a firm determines that	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
		Specific comments	<p>there are no engagements for which an engagement quality review is an appropriate response to address the quality risks is appropriate (Proposed Standard – page 18). The Group is not clear on how SFSPs are going to satisfy No. 2 when there are limitations on the eligibility of an individual to be an engagement quality reviewer.</p> <p>The Group appreciates the clarification of the qualifications of an engagement quality reviewer, and the specified responsibilities of both the engagement partner and the engagement quality reviewer, and believes that for larger firms the proposed standard is appropriate.</p>	
40	92	QM2 Overall\ Specific comments	We believe the appropriate use of engagement quality reviews can be an effective response to quality risks and that the objectivity of an engagement quality reviewer increases as the cooling- off period increases. The length of an appropriate cooling-off period can vary based on the complexity of the engagement.	Noted
41	93	QM2 Overall\ Specific comments	<p>We believe it is beneficial to have the Engagement Quality Review guidance in a separate standard. We believe the requirements are consistent with the existing literature and will provide appropriate guidance to firms in implementing this process. One could make the argument to make a more standard uniform across all firms, that every firm would need to seek an outside quality control reviewer to keep the impacts of the new standard fair across all firm types and sizes</p> <p>We believe the proposed requirements may not be affordable or achievable by small firms. Typically, firms rely upon qualified professionals to perform EQCRs outside the firm. Firms currently utilize peer reviewers who are qualified to perform EQCRs. Because the peer reviewer pool is shrinking, it is challenging for a firm to locate a qualified individual to perform an EQCR. Small firms who are required to utilize the services of an outside review may be prohibited to continue their work due to cost restraints. Our firm will and does need an outside EQCR on a rare occasion if we do take an engagement outside the scope of our main practice areas.</p>	Noted
42	97	QM2 Overall\ Specific comments	<p>how does this change what is now in place with EQCR? It makes it more difficult in the inuendo that firms that don't have enough internal partners need to go outside to get an external person to do the review work. The proposed standard does not help the situation; it makes it more cumbersome.</p> <p>Again, a lack of understanding of the resources available to small firms. Most small firms do</p>	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			not have the luxury of appointing a partner as the quality control reviewer who has not worked on the engagement in the current or preceding years. The caveat of having an external reviewer further displays a lack of understanding of the resources available and the growing costs of implementation.	
43	98	QM2 Overall\ Specific comments	<p>We believe it is beneficial to have the Engagement Quality Review guidance in a separate standard. We believe the requirements are consistent with the existing literature and will provide appropriate guidance to firms in implementing this process. One could make the argument to make a more standard uniform across all firms, that every firm would need to seek an outside quality control reviewer to keep the impacts of the new standard fair across all firm types and sizes</p> <p>We believe the proposed requirements may not be achievable for small firms. Under extant standards, firms rely on peer reviewers to perform EQCRs. The new standards appear to increase the need for small firms to seek this outside assistance with EQRs and internal inspections due to the cooling off period requirement. Because the peer reviewer pool is shrinking and the increased need for these types of individuals, it will be even more challenging for a firm to locate a qualified individuals to perform an EQR. Small firms who are required to utilize the services of an outside reviewer may be inhibited in performing their services timely due to availability.</p>	Noted
44	102	QM2 Overall\ Specific comments	<p>The majority of the Committee members from the standpoint of small and medium sized firms are in agreement with the Engagement Quality Review Standard. It is the belief that Firms could assess an engagement at a lower risk and thus perform a lesser review of that engagement such as a technical review of that engagement. The majority believe this will be of benefit to the small and medium firms when performing less complex audits and other engagements.</p> <p>The downside is that the small firm may be forced out of performing complex audits if it does not have non-engagement members with expertise to perform the review. The majority of the Committee contend this engagement quality review requirement will require that a Firm reflect on its ability to properly perform that audit and take appropriate step to insure compliance.</p>	Noted
45	103	QM2 Overall\ Specific comments	We support having clear requirements for policies and procedures addressing the appointment and eligibility of engagement quality reviewers and performance of	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
		Specific comments	<p>engagement quality reviews. The requirements in proposed SQMS No. 2 are clear and understandable and the application materials are helpful in supporting the application of those requirements. However, there are some areas of the standards that we believe need additional clarification or consideration.</p> <p>In instances where the firm determines that an engagement quality review is required, the appointment and eligibility of reviewers may be difficult or costly for sole practitioners and small firms with limited personnel as they would be required to contract with individuals external to the firm to perform the engagement quality review, in addition to the cost of their peer reviewer. Guidance on vetting and retaining the services of qualified individuals and resources to assist firms with finding suitable reviewers should be made available.</p> <p>Proposed SQMS No. 2 identifies threats to objectivity of the engagement quality reviewer and specifies a minimum cooling-off period of two years before the individual can be appointed to the role of engagement quality reviewer. This requirement could have an impact on sole practitioners, smaller firms, and even local offices of larger firms with specialty niche areas. The standards should allow for alternatives to the minimum cooling-off periods, in certain instances, while lowering the self-review threat to an acceptable level.</p>	
46	109	QM2 Overall\ Specific comments	<p><b>Why a Separate Standard?</b> The Committee agrees with having a separate standard on choosing an engagement quality reviewer and the performance of an engagement quality review. The separation provides clarity and distinction of the process from the design and operation of a quality management system.</p> <p><b>Appointment and Eligibility of Reviewers</b> The Committee feels that there should be specific guidance on who is eligible to perform an engagement quality review; however, we have several concerns that some requirements will make meeting these requirements difficult. We are also concerned that the Cooling- off period (Par. 19, A16-A17) is not necessary. This concern is also related to the ability of the firm to find enough eligible reviewers inside the firm. These restrictions combined with other independence requirements and the difficulty in finding external resources could force firms to incorrectly conclude an engagement is outside engagement quality review requirements to avoid violating eligibility guidelines.</p>	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			<p>Performance and Documentation of the EQ Review</p> <p>The Committee agrees with the different aspects of the performance and documentation of the EQ review (Significant Judgments and Significant Matters, Time of the Review, and Documentation).</p> <p>The Committee feels the requirements in proposed SQMS No. 2 are clear and understandable. The application material is helpful; however, we believe significant implementation guidance will need to be provided, especially to smaller firms.</p>	
47	139	QM2 Overall\ Specific comments	The engagement quality reviewer is required to take overall responsibility for the performance of the engagement quality review and for documenting the engagement quality review. The documentation of the engagement quality review is required to be included with the engagement working papers of the engagement on which the engagement quality review was performed. Has the ASB considered to what extent a contracted engagement quality reviewer has exposed themselves to litigation since they could be perceived as being part of the quality control of the firm to which they were contracted?	Not a change from extant.
48	146	QM2 Overall\ Specific comments	As noted above in 2a, the standards are written in such a way that they would require a firm with fewer than two or three audit partners to obtain additional resources to comply. This outcome will either increase costs for smaller firms to look for outside resources to fulfill the engagement quality review (EQR) and/or quality review roles or cause smaller firms to cease providing auditing services. Additionally, cost is not the only issue. There just are not enough “good” A&A individuals, and many (including peer reviewers) might be able to help firms with inspections but not with EQR or anything requiring pre-issuance. Our fear is that the smaller firms will find a similar small firm and trade services, and neither firm will be technically proficient enough to do a good job. They will catch typos and missing “sign offs” but miss the technical issues. These firms will have “technically” met the requirement, but quality will not be improved in any substantial way.	Noted
49	148	QM2 Overall\ Specific comments	The requirements proposed in SQMS No.2 are clear and understandable however, the requirements may pose a financial and accessibility barrier for sole practitioners and smaller firms. Viable options for sole practitioners and smaller firms will need to be identified prior to the implementation actions or dates for these standards.	Noted
50	150	QM2 Overall\ Specific comments	Our view on the preceding changes are we agree with the change to the approach that emphasizes the responsibility of firm leadership for proactively managing the quality of their	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			respective engagements. We also agree with the concept of scalability as stated above. The application material is helpful in supporting the application of those requirements.	
51	151	QM2 Overall\ Specific comments	For our firm the existing requirements for policies and procedures addressing the appointment and eligibility of engagement quality reviewers and performance of engagement quality reviewers is adequate under SQMS No. 8. Through the peer review process our firm has observed whenever it has been detected through our peer review, these policies need to be modified, we have appropriately done so through either our inspection/monitoring or through the peer review process. However, for those firms that would be affected by this proposed SQMS, the requirements in proposed SQMS No. 2 are clear and understandable, and the application materials would be helpful.	Noted
52	155	QM2 Overall\ Specific comments	Generally, the preceding changes discussed in the proposed SQMS No. 2 were clear and understandable. The application material is helpful and supports the application of the requirements.	Noted
53	40	QM2 requirements	We believe that the requirements in SQMS No. 2 are clear and understandable and that the application material is helpful. We provide suggestions to clarify the application guidance.	Noted
54	121	QM2 requirements	Yes, the requirements in proposed SQMS No.2 are clear and understandable.	Noted
55	65	QM2 requirements\ Additional comments	The ED is consistent with my former firm’s system and supporting policies and procedures.	Noted
56	130	QM2 requirements\ Additional comments	It is not entirely clear what the required firm policies or procedures should be that will include limitations on the eligibility of an individual to be appointed and serve as an engagement reviewer where the individual previously served as engagement partner.	Noted
57	143	QM2 requirements\ Additional comments	D&T does not believe that it is appropriate to only use the plural form of “individuals” and recommends that all instances of the use of “individuals” be aligned with international QM standards (i.e., “individual(s)”). See further discussion above in response to Question 1 (SQMS No. 1, paragraph 10).	Agreed; revised
58	55	QM2 requirements\ No	However, some of the Committee members expressed concerns about a potential adverse effect from the EQR requirements about the appointment and eligibility of reviewers. The limitations in the eligibility of the reviewers seem to be very restrictive, and, especially in combination with the 2-year cooling-off period, smaller firms may look to circumvent the use of EQR to avoid the issue of engagement partner rotation or having to hire a reviewer	Noted

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Row	CL #	Category	Coded Text	Task Force Comments
			outside of the firm. It would be preferable to utilize a risk-based approach and emphasize that firms meet the ethical requirements as contained in the proposed standard, rather than rely on a pre-determined cooling-off period.	
59	100	QM2 requirements\ Other	The requirements in SQMS No. 2 are clear and understandable; however, TIC believes that they may be difficult for some firms to implement.	Noted
60	134	QM2 Requirements\ Paragraph 12	Objective of the standard As proposed, the standard’s objective is unclear, particularly in light of our prior comment about EQ reviews no longer being part of US GAAS. We believe this standard essentially contains two objectives and, as drafted, does not sufficiently capture the two aspects of EQ review requirements contained within the proposed standard. There are requirements specific to the firm establishing its EQ review process, and there are differing requirements for EQ reviewers and for the actual execution and documentation of an EQ review. We believe separating the objectives into bullets would enhance the clarity of such objectives and better enable firms to ensure they have captured all aspects of the requirements in their systems of quality management. In addition, a separate objective for the EQ reviewer would further clarify the EQ reviewer’s responsibility to comply with the proposed standard.	No other comments on objective. Introduction provides clarifying information. No change proposed.
61	109	QM2 requirements\ Paragraph 18a	With the current shortage of accounting professionals, finding a reviewer outside the firm may be challenging with sufficient time (Par. 18a) to perform the review.	If the firm has qualified people not on the engagement team, the firm is not required to find review outside the firm. No change
62	134	QM2 requirements\ Paragraph 18	Appointment and eligibility of reviewers We are generally supportive of the proposed requirements regarding the eligibility of individuals to be appointed as an EQ reviewer or as an assistant to an EQ reviewer. While we appreciate that the standard deals with the authority, or perceived authority, of the EQ reviewer through the requirement in paragraph 18(a) and the related application material, experience indicates that difficulties can still arise when the EQ reviewer is of a grade lower than that of the engagement partner (or leader). We would therefore recommend that the application material provide further guidance on policies and procedures related to the notion of “sufficient authority,” considering scalability for smaller firms. In addition, we note that the application material, specifically paragraph A10, indicates that the authority of the EQ reviewer becomes diminished where the EQ reviewer has a reporting	To be addressed thru implementation guidance.

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			line to the engagement leader. This may not always be possible, and we recommend that the proposed standard include guidance that provides examples of the safeguards that a firm could put in place where it is not practical.	
63	134	QM2 requirements\ Paragraph 20 and par. A17	Paragraph 20 of proposed SQMS 2 allows for individuals to assist the EQ reviewer in the performance of the review. Firms might interpret the related example in the application material to mean that using assistants in the performance of an EQ review would be appropriate only in circumstances where specialized knowledge, skills, or expertise is needed in the execution of the review. We do not believe that this was the intention of the requirement and recommend that the Board revisit the guidance in this regard. Further, we note that one of the factors to consider in the appointment of an EQ reviewer is whether the reviewer would have sufficient time to fulfill the role. The appointment of assistants to help the EQ reviewer in the performance of the review might be helpful in circumstances where there is a limited pool of available EQ reviewers from which to draw.	Revised application guidance.
64	147	QM2 requirements\ Paragraph 18	Paragraph 18a requires the firm to establish policies and procedures to select a qualified engagement quality reviewer. We suggest some consideration of documenting the selection and qualification of the reviewer would further enhance this process, particularly in cases where the engagement quality reviewer may be from another firm.	No change; documentation requirements are principles-based.
65	61	QM2 requirements\ Paragraph 24	SQMS No. 2, paragraphs 24b, A24, and A25, describe engagement partner responsibilities in relation to the engagement quality review as provided in the auditing standards. We believe this section should discuss all levels of services, including those not currently having specific requirements related to EQR under the respective standards. SQMS No. 2 contains various other paragraphs in the Application and Other Explanatory Material that reference auditing standards, and do not address other levels of service. We believe the concepts apply to all levels of service; highlighting and referencing only auditing standards could be misconstrued. Further, guidance is needed on how to apply the quality management standards when the respective standards for the relevant level of services do not address that element; the quality management standards do not need to replicate extant guidance. We further believe that conforming amendments to the relevant Statements on Standards for Accounting and Review Services (SSARS) or the Statements on Standards for Attestation Engagements (SSAEs) may be needed to address this concern.	<ul style="list-style-type: none"> <li>• Nothing exists to refer to in SSARS yet.</li> <li>• Conforming amendments to SSARS will be exposed by ARSC; conforming amendments to SSAEs included in ED.</li> </ul>
66	47	QM2 requirements\ Paragraph 24	Our understanding is that the intent of paragraph 24.a. allows the firm to set policy and procedures so that, for example, the engagement quality review could be performed at the end of the engagement. However, as currently written, Paragraph 24.a. appears to require	Implementation guidance to explain that <i>appropriate</i> points in time

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			engagement quality review at various points in time. We recommend clarification to the requirement.	during the engagement may be at the end of the engagement, for smaller engagements.
67	76	QM2 requirements\ Paragraph 24	As noted above, the timing of review as proposed would require identification of the EQ review up front on every engagement in theory as significant judgments/matters may arise at any point during an engagement. This is impractical at a small firm and would be virtually impossible to implement. Additionally, in a small firm environment, audit partners are much more involved during the course of the entire audit process and therefore any significant judgments /matters are being addressed by partner level personnel. An EQR at the end of the engagement prior to report issuance is 100% adequate in these situations.	Implementation guidance to explain that <i>appropriate</i> points in time during the engagement may be at the end of the engagement, for smaller engagements.
68	103	QM2 requirements\ Paragraph 24	We support the requirement for the engagement quality review to be performed at appropriate points in time during the engagement to provide an appropriate basis for an objective evaluation of the significant judgements made by the engagement team and the conclusions reached thereon. However, this requirement could be difficult to implement in a cost-effective manner when there is an external engagement quality reviewer involved. Some sole practitioners and smaller firms still manually prepare their audit documentation or may need information technology upgrades to allow for timely access to the data throughout the engagement.	Implementation guidance to explain that <i>appropriate</i> points in time during the engagement may be at the end of the engagement, for smaller engagements.
69	130	QM2 requirements\ Paragraph 24	The requirement that the engagement quality review perform the procedures at certain points in time during the engagement is generally more important when audit engagements have thousands or tens of thousands of hours during the period of professional engagement. For smaller firms that perform audits that have hundreds of hours, this requirement appears less necessary and becomes burdensome and overly restrictive. Audits that have several hundred hours are performed more fluidly and the benefit of coordinating and documenting the performance of certain aspects of the quality review is not cost effective by starting, stopping, performing certain procedures and ensuring the documentation and sign-off before other procedures can be performed. We do however support the requirement that the documentation of the engagement quality review be filed with the engagement documentation and that it be in sufficient detail to allow an experienced practitioner to understand the nature timing and extent of procedures performed.	Implementation guidance to explain that <i>appropriate</i> points in time during the engagement may be at the end of the engagement, for smaller engagements.
70	139	QM2 requirements\ Paragraph 24	The engagement quality reviewer is responsible to perform procedures at appropriate times during the engagement. This requirement does not seem practicable for small firms and sole proprietors who will more likely than not have to find an engagement quality reviewer from	Implementation guidance to explain that <i>appropriate</i> points in time

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			outside of their firm. There is a variation in practice of how working papers are maintained so does the ASB anticipate the engagement quality reviewer making multiple visits to the firm to complete the engagement quality review?	during the engagement may be at the end of the engagement, for smaller engagements.
71	144	QM2 requirements\ Paragraph 24	Related to the “appropriate points in time” requirement, what about situations where it is only decided later in an engagement that an EQR should be performed? Would that be allowed under the proposed standard?	Implementation guidance to explain that <i>appropriate</i> points in time during the engagement may be at the end of the engagement, for smaller engagements.
72	146	QM2 requirements\ Paragraph 24	We also feel that requirements for timing of an EQR be revisited to take into consideration smaller firms performing smaller engagements. It may be difficult to have the involvement of the EQR done in intervals.	Implementation guidance to explain that <i>appropriate</i> points in time during the engagement may be at the end of the engagement, for smaller engagements.
73	166	QM2 requirements\ Paragraph 24	<p>Requiring the engagement quality reviewer to be a partner not involved in the engagement seems like it might be an impossible task for a lot of small practices. I can imagine a scenario where the engagement quality reviewer could be engaged from an outside firm, but the requirement that they should be involved throughout different points in the audit would likely be very difficult. I’m trying to imagine how this would be economically feasible for many audits and I’m trying to imagine who we would be able to contract with for this kind of service. In my practice I could see where a manager not involved in the audit could fill this role effectively, but I’m not clear that this meets the criteria called for in the proposed standard.</p> <p>From the point of view of a professional being hired to fill this role for another audit firm, I would need more clarification on what that engagement should look like, and what kind of risk I am assuming by taking on that role.</p>	Implementation guidance to explain that <i>appropriate</i> points in time during the engagement may be at the end of the engagement, for smaller engagements.

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74	134	QM2 requirements\ Paragraph 24	<p>Performance and documentation of the EQ review</p> <p>In principle, we agree that the EQ reviewer’s evaluation of significant judgments includes evaluating the engagement team’s exercise of professional skepticism, required by proposed paragraph 22(c)(i). However, professional skepticism is a state of mind and may not be evidenced by specific documentation, which in turn would make it difficult for the EQ reviewer to evaluate and demonstrate the evaluation performed as part of the EQ review. We urge the Board to consider further guidance in the standards in this area, both on how engagement teams evidence their exercise of professional skepticism (likely in proposed QM SAS) and how the EQ reviewer evidences the evaluation of the engagement team’s exercise of professional skepticism.</p> <p>As an aside, we note that this proposed standard refers to “exercising” professional skepticism while GAAS refers to “maintaining” or “applying” professional skepticism. Consideration may need to be given as to the consistency of these phrases across standards issued by the ASB and ARSC.</p> <p>Timing of the review</p> <p>We support the proposed requirement for the EQ reviewer to perform EQ review procedures at appropriate points in time during the audit. This would allow for a more thorough review by the EQ reviewer and would afford the engagement team adequate time to respond appropriately to the EQ reviewer’s questions and comments. Please also refer to our response to Question 9 below, which provides additional feedback with regard to the timing of EQ reviews.</p>	<ul style="list-style-type: none"> <li>• For consideration in implementation material.</li> <li>• Agree; this is a change between IAASB and ASB style, as demonstrated in SAS No. 145 vs ISA 315 (Revised 2019)</li> </ul>
75	61	QM2 requirements\ Paragraph 25	<p>Review of financial statements and the engagement report thereon as referenced in paragraphs 25.g.ii and .A47:</p> <p>Should the reference to “engagement report” in these two paragraphs be replaced with “review report”?</p>	<ul style="list-style-type: none"> <li>• Agree</li> </ul>
76	161	QM2 requirements\ Paragraph 25	<p>Paragraphs 25(b) and 25(c) of proposed SQMS No. 2 explain that the engagement quality reviewer should discuss significant matters and significant judgments made in planning, performing, and reporting on the engagement. Paragraph A35 of proposed SQMS No. 2 simply refers to paragraph A92 of proposed AU-C 220, which provides examples of matters that may be significant judgments requiring engagement partner review. We believe that, without further context, this could potentially be interpreted as a requirement that the engagement quality reviewer evaluate all significant judgments and related documentation and conclusions reached by the engagement partner, effectively expanding the scope of EQR</p>	<p>Deleted “the” from “the significant judgments” in 25(c) to be consistent with par. 25(b).</p> <p>Considered adding “ The firm’s policies or procedures may specify</p>

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			<p>review requirements without allowing for judgment in the identification of review areas for the EQR. This limits flexibility in the application of the standard and would likely result in significantly more time spent on the EQR that may be practicable.</p> <p>We believe the ASB should consider reorganizing and enhancing the application material to first explain that AU-C section 220 includes examples of significant judgments that may be reviewed by the engagement partner (paragraph A35) and provide additional context about the role of the engagement quality review with respect to those judgments (new application material), then clearly explain that the firm’s policies and procedures are expected to set out what the engagement quality reviewer is required to review (enhanced paragraph A39), and that the discussion contemplated by paragraph 25(b) may identify other areas that warrant review by the engagement quality reviewer in the context of the nature and circumstances of the engagement (new application material).</p>	<p>certain matters that are commonly expected to be significant judgments” as the last sentence in par. A35; TF did not think this change was necessary.</p>
77	161	QM2 requirements\ Paragraph 25	<p>Finally, as described in our response to Question 4, we are concerned with the new requirement in paragraph 31 of the proposed QM SAS, in particular what evidence would need to be documented to support the engagement partner’s determination in accordance with paragraph 40 that the engagement partner’s involvement has been sufficient and appropriate throughout the audit engagement and comply with the requirements of the SAS. While we understand the basis for this “stand back” in the proposed QM SAS, we do not believe it is appropriate to mirror this requirement in the context of an EQR (paragraph 25(f) of proposed SQMS No. 2). In our view, requiring the engagement quality reviewer to evaluate the basis for the engagement partner’s determination that the engagement partner’s involvement has been sufficient and appropriate goes beyond the objective of an EQR.</p> <p>That being said, we acknowledge that it would be appropriate for the engagement quality reviewer to take action should concerns arise that the engagement partner was not sufficiently and appropriately involved during the audit and therefore did not have an appropriate basis for the conclusions reached. The requirement in paragraph 26 of proposed SQMS No. 2 requires the engagement quality reviewer to notify the engagement partner (and potentially appropriate individuals in the firm) if the engagement quality reviewer has concerns that the significant judgments made by the engagement team, or the conclusions reached thereon, are not appropriate. We believe paragraph 25(f) could be deleted and its intent more clearly articulated in the context of paragraph 26. We note that paragraph A49 acknowledges that the firm’s policies and procedures may specify the individuals in the firm</p>	<p>No change; this would be a significant departure from ISQM 2</p>

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			to be notified if the engagement quality reviewer has unresolved concerns, which we believe could be expanded upon to specifically highlight concerns about the extent of the engagement partner’s involvement.	
78	161	QM2 requirements\ Paragraph 25	<p>While we support clarifying the nature and extent of work expected of an engagement quality reviewer, it is important to recognize the respective roles of the engagement partner and engagement quality reviewer. The role of an engagement quality reviewer is not to repeat all of the same responsibilities as the engagement partner to act as a “check” on all of the judgments made. The engagement quality reviewer supports quality on the engagement by bringing an objective perspective to the significant judgments made by the engagement team. However, the engagement quality reviewer is not able to make an independent assessment as to whether the significant judgments identified by the engagement team represent a complete population, as this would effectively mean reviewing all areas of the engagement and related audit documentation. As acknowledged in paragraph A39, the firm’s policies and procedures will likely describe a baseline of significant judgments that need to be reviewed by the engagement partner and evaluated by the engagement quality reviewer.</p> <p>To the extent there are significant judgments that the ASB believes should always be evaluated by the engagement quality reviewer, we support including those as direct requirements; for example, those contemplated by paragraph 10 of PCAOB AS 1220.</p>	No change; existing AM is sufficient and adding direct requirements like those in AS 1220 would not be appropriate for principles-based standards for non-issuers.

**Commented [AG1]:** Okay to say?

**Commented [JH2R1]:** I think for the first paragraph and last, that this is correct. The middle paragraph seems to focus on some of the stuff in line 76 above. See my suggestions in the marked version of 4c.

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79	143	QM2 requirements\ paragraph 26	<p>Although we agree “a lack of appropriate level of professional skepticism by the engagement team” is an area of concern that may be raised by the engagement quality reviewer, we do not believe it is necessary to diverge from the wording of a requirement in ISQM 2 to reiterate this concept, as it is already addressed in paragraphs 25, A28, A40, A41, and A42 of proposed SQMS No. 2. A change to the wording of a requirement as compared to the International QM standards is a signal that the ASB thinks different or additional procedures should be performed, and we do not believe this is the case.</p> <p>In the event that the ASB decides to retain the additional phrase (as compared to ISQM 2) in paragraph 26 of proposed SQMS No. 2, we have a recommended revision. We do not believe the phrase “when applicable” is clear as written, as it may be misinterpreted to imply there are circumstances when an engagement team is not expected to maintain professional skepticism. For clarity, we recommend the phrase “to the type of engagement” be added, as this is the same construct used in paragraph 25 of proposed SQMS No. 2.</p> <p>We also recommend additional edits as indicated below as conforming changes (moving from “exercise of professional skepticism” to “maintenance of professional skepticism”) both in this paragraph and throughout the proposed QM standards.</p> <p>26. The engagement quality reviewer should notify the engagement partner if the engagement quality reviewer has concerns that the significant judgments made by the engagement team, including the appropriate <del>exercise</del> <b>maintenance</b> of professional skepticism by the engagement team when applicable to the type of engagement, or the conclusions reached thereon, are not appropriate. If such concerns are not resolved to the engagement quality reviewer’s satisfaction, the engagement quality reviewer should notify appropriate individuals in the firm that the engagement quality review cannot be completed. (Ref: par. A49)</p>	<p>Revised to include “type of engagement”</p> <p>Agree; this is a change between IAASB and ASB style, as demonstrated in SAS No. 145 vs ISA 315 (Revised 2019)</p>
80	162	QM2 requirements\ Paragraph 30b	<p>Yes, we believe the requirements in SQMS No. 2 are clear and understandable. However, we have concerns on the expectations regarding proposed SQMS No. 2, paragraph 30b, and the requirement to identify the engagement documentation the EQR reviewed. We feel such a requirement may be interpreted in an overly prescriptive manner and may impede audit quality by encouraging certain EQRs to take an “all or nothing” approach to reviewing documentation and not even look at certain documentation, even in a high-level manner, for concern of being associated as a reviewer of the specific documentation. We recommend additional application guidance be provided or that paragraph 30b be removed.</p>	<p>Consider for implantation guidance to clarify that for example, one tab of a worksheet may be reviewed but not the other tabs.</p>

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81	47	QM2 requirements\ Paragraphs 28-30	Paragraphs 28 through 30 detail the documentation requirements for the engagement quality review. NASBA is concerned that the standard’s documentation requirement may be more onerous than is needed for smaller, less complicated audits. We recommend the ASB consider whether the documentation requirement can be made more scalable for these engagements.	No change: All that’s asked is: <ul style="list-style-type: none"> <li>• Who reviewed</li> <li>• What was reviewed</li> <li>• That they “approved” it</li> <li>• And when they finished.</li> </ul>
82	134	QM2 requirements\ Paragraphs 28-30	Documentation We agree with the enhanced documentation requirements and believe that these enhanced requirements reflect what many firms currently require engagement teams to include in the engagement file as evidence of the EQ review. Paragraph-level observations and recommendations We identified the following paragraph-level observations and recommendations for the Board’s consideration: We recommend the Board revise paragraph 25(f) to refer to “audit engagements” as opposed to “audits of financial statements.” The more general term would then encompass audits of internal control that are integrated with audits of financial statements and compliance audits. We do not believe it is the Board’s intention to exclude these audits from the requirements. In the third bullet of paragraph A6, we ask the Board to clarify the language so that it more closely aligns with how specialists are defined in US GAAS.	Agree, revised  QM2 uses the word “expertise” which is used in AU-C 620.
83	147	QM2 requirements\ Paragraphs 28-30	The proposed SQMS requires that documentation of the engagement quality review be maintained with the audit documentation (paragraphs 29 – 30). Although we believe that including documentation showing evidence that the quality review was performed is warranted, we believe that overly detailed documentation in the audit file, including findings and conclusions reached could impair objectivity in performing the next engagement and potentially expose the firm to risk. We believe more clarification is warranted as to what quality review documentation should be kept with audit files.	For consideration as implementation guidance. No change from current practice intended.
84	089	30	Application guidance should be more clear on what is expected for documentation to be “sufficient to enable an experienced practitioner, having no previous connection to the	No change from current practice; adapt AU-C 230.

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			engagement, to understand the nature, timing, and extent of the EQR procedures performed”. While the documentation should be detailed enough to understand who performed the review and the scope of their review, a level of documentation that seems to indicate “reperformance” would be a bit too stringent. Also see response to question 8.	
85	65	QM2 requirements\Y	Yes	Noted
86	102	QM2 requirements\Y	The requirements are clear and understandable.	Noted
87	138	QM2 requirements\Y	Yes	Noted
88	156	QM2 requirements\Y	Yes, based on our initial reading of SQMS No. 2, although our review has not been extensive.	Noted
89	159	QM2 requirements\Y	Yes	Noted
90	164	QM2 requirements\Y	Yes, the requirements are clear and understandable.	Noted
91	168	QM2 requirements\Y	The requirements are clear and understandable.	Noted
92	121	QM2 AM	Yes, the application material in proposed SQMS No. 2 is helpful in supporting the application of the requirements. Implementation materials and other nonauthoritative guidance would be beneficial particularly as it relates to the requirement for the engagement quality reviewer in an audit to evaluate the basis for the engagement partner’s determination of their sufficient and appropriate involvement throughout the audit (proposed SQMS No. 2 para. 25.f.) the factors that should be considered in determining if the performance requirement of the engagement quality review has been achieved (proposed SQMS No. 2 para. 27.) examples of documentation recommended for the engagement quality reviewer depending on the size and complexity of the engagement.	Noted
93	65	QM2 AM\ Additional comments	My former firm has extensive policies and procedures in place for addressing the management of quality at the engagement level, emphasizing the importance of the exercise of professional skepticism, enhancing the documentation of the auditor’s judgments, and robust communications during the engagement.	Noted
94	65	QM2 AM\	The ED is consistent with my former firm’s system and supporting policies and procedures.	Noted

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		Additional comments		
95	76	QM2 AM\No	NO [AM is not clear]	Noted
96	143	QM2 AM\ paragraph A3	Paragraph A3 D&T believes adding “attestation examination engagements” is unnecessary and recommends simply referring to “other engagements.” A3. The firm may assign more than one individual to be responsible for appointing engagement quality reviewers. For example, the firm’s policies or procedures may specify a different process for appointing engagement quality reviewers for audits of financial statements than for <del>attestation examination engagements</del> or other engagements, with different individuals responsible for each process.	Added because attestation examinations are also reasonable assurance engagements. No change.
97	143	QM2 AM\ Paragraph A11	D&T believes the requirements are clear and understandable and the application material is helpful. However, D&T believes the proposed example added to paragraph A11 in proposed SQMS No. 2 to demonstrate a scenario when “compliance with independence requirements may not apply” could have significant unintended consequences and therefore should be removed. As currently written, the example does not address the fact that the firm may still need to be independent of the entity for a reason other than the fact that an individual within that firm has performed an engagement quality review related to that entity. If the example is not removed, at a minimum the edits shown below should be made to provide clarity and indicate the example relates to a scenario that may exist for a smaller firm. We also believe the other proposed differences from ISQM 2 are unnecessary modifications, and we recommend converging. A11. The relevant ethical requirements that are applicable when undertaking an engagement quality review may vary, depending on the nature and circumstances of the engagement or the entity. <del>Various provisions of relevant ethical requirements may include various provisions, such as specific independence requirements, that apply only to an individual, such as an engagement quality reviewer, and not the firm itself. For example, if a smaller firm uses an external provider to perform an engagement quality review, that individual may be subject to independence requirements, but the entire firm for whom the individual works may not need to comply with independence requirements related to the entity however, the independence requirements</del>	Agree with proposed revisions

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			<p><u>imposed on that individual, because that individual is performing the engagement quality review on a specific entity, may not necessarily extend to the entire firm for which the individual works.</u></p>	
98	40	QM2 AM\ A13	<p>Application Guidance: SQMS No. 2</p> <p>Define close personal relationship as used in paragraph A13. The AICPA Code of Professional Conduct provides a definition of close relative in paragraph .08, Close relative: A parent, sibling, or nondependent child. [Prior reference: paragraph .04 of ET section 92.]</p> <p>Add language to the examples in paragraph A13 to explain why a threat to the engagement quality reviewer’s objectivity may be affected similar to those in the AICPA Code of Professional Conduct’s Topic 1.210 – Conceptual Framework Approach. We also suggest adding the language underlined below to paragraph A13.</p> <p>Paragraph A13:</p> <p>Threats to the engagement quality reviewer’s objectivity may be created by a broad range of facts and circumstances. Examples follow:</p> <p>A self-review threat may be created when the engagement quality reviewer previously was involved with significant judgments made by the engagement team, in particular, the engagement partner or other engagement team member. <u>There is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to preserve the reputation of the engagement team, partner, other engagement team member or their previous involvement in the engagement.</u></p> <p>A familiarity or self-interest threat may arise when the engagement quality reviewer is an immediate family member of the engagement partner or another member of the engagement team, or through close personal relationships with members of the engagement team. <u>There is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to preserve the reputation of the engagement team, partner, other engagement team member or their previous involvement in the engagement. Such a relationship may make the engagement quality reviewer sympathetic to the engagement partner or another member of the engagement team. With a self-interest threat, there is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to obtain a financial or nonfinancial benefit from the engagement partner or other members of the engagement team.</u></p>	<p>One comment to strengthen guidance in A13; two comments that A13 over-emphasizes the self-review threat. Accordingly, no change proposed.</p>

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			An intimidation threat may be created when actual or perceived pressure is exerted on the engagement quality reviewer (for example, when the engagement partner is an aggressive or dominant individual, or the engagement quality reviewer has a reporting line to the engagement partner). <u>With an intimidation threat, there is the likelihood that the engagement quality reviewer will not apply the appropriate level of due diligence or may overlook an error or other discrepancy to preserve the reputation of the engagement team, partner, other engagement team member due to intimidation from members of the engagement team, engagement partner, or others.</u>	
99	81	QM2 AM\ Paragraph A13	However, we do not support paragraph A13 regarding the familiarity or self-interest threat to objectivity that may arise when the engagement quality reviewer is a close or immediate family member of the engagement partner or another member of the engagement team or has a close personal relationship with members of the engagement team. This requirement disadvantages small firms, such as ours, as many small firms may consist of close or immediate family members working together or partners that have worked closely together for many years. The ASB should remain confident that practitioners will exercise and maintain objectivity under relevant ethical standards.	One comment to strengthen guidance in A13; two comments that A13 over-emphasizes the self-review threat. Accordingly, no change proposed.
100	109	QM2 AM\ Paragraph A13	We feel there may be too much emphasis placed on the self-review threat (Par. A13).	See row above.
101	143	QM2 AM\ Paragraph A23	The guidance relates to policies and procedures that a firm may have in place when an engagement quality reviewer, who becomes aware of circumstances that would impair their eligibility, is replaced. Because D&T believes the last bullet is an action to be performed by the engagement team rather than the engagement quality reviewer who is replacing the impaired engagement quality reviewer, the bullet should be removed from the list. If the intent is that the new engagement quality reviewer or the engagement partner be required to document the circumstances necessitating a change in the engagement quality reviewer, the bullet should be clarified.  In addition, D&T believes the description of the procedures performed by the engagement quality reviewer described in the first bullet should be clarified.  A23. In circumstances in which the engagement quality reviewer’s eligibility to perform the engagement quality review becomes impaired, the firm’s policies or procedures may set out a process by which alternative eligible individuals are identified. The firm’s policies or procedures may also address the responsibility of the individual appointed to replace the	Standard doesn’t prescribe who needs to document, just that it is. “Who” and “how” should be left to the firm and team. No change  Revised first bullet; retained last bullet.

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			<p>engagement quality reviewer to perform procedures sufficient to fulfill the requirements of this proposed SQMS with respect to the performance of the engagement quality review. Such policies or procedures may further address the need for consultation in such circumstances and may include, for example, the following:</p> <ul style="list-style-type: none"> <li>• Evaluation of whether any <del>review work that has been</del> <u>procedures</u> performed by the <u>previous</u> engagement quality reviewer could be relied upon by the newly assigned engagement quality reviewer or whether all work would need to be reperformed</li> <li>• Consideration of the effect of an engagement quality review assistant on the transition, when such assistant has been involved in the engagement quality review prior to transition</li> <li>• Procedures undertaken by the engagement team to inform the newly assigned engagement quality reviewer about planning meeting discussions that have already occurred and other matters in which the previous engagement quality reviewer had been involved</li> <li>• <del>Documentation of the circumstances necessitating the change</del></li> </ul>	
102	61	QM2 requirements\ Paragraph A47	The last sentence in paragraph .A47 indicates that the guidance in this paragraph also applies to review engagements and the related engagement report. Is this sentence necessary as any such non-audit engagements would be covered by paragraph A48?	<ul style="list-style-type: none"> <li>• Added “or reviews” to par. A48</li> </ul>
103	143	QM2 AM\ Paragraphs A47-A48	<p>Paragraphs A47 and A48</p> <p>D&amp;T believes it is unclear which professional standards are applicable in each application paragraph and recommends the guidance include reference to the relevant professional standards (i.e., SAS, SSAE, SSARS). For example, the last statement in paragraph A47 of proposed SQMS No. 2 refers to “review engagements,” but it is unclear whether this phrase is referring to reviews within the SASs or SSARSs.</p> <p>The lead-in to paragraph A48 of proposed SQMS No. 2, which was modified from ISQMS No. 2, states that this paragraph applies to “engagements other than audits of financial statements,” implying paragraph A47 of proposed SQMS No. 2 relates only to “audits of financial statements.” However, the last statement in paragraph A47 states the guidance also applies to review engagements. Therefore, the statement in paragraph A48 to exclude audits of financial statements should include “or reviews.”</p> <p>Review <b>by Engagement Quality Reviewer</b> of Financial Statements and Engagement Reports (Ref: par. 25g)</p>	<p>Agree, revised; footnotes not added.</p>

Agenda Item 4D – Detailed Comments QM 2

Row	CL #	Category	Coded Text	Task Force Comments
			<p>A47. For audits of financial statements, the engagement quality reviewer’s review of the financial statements and auditor’s report thereon is consistent with the engagement quality reviewer’s understanding of those matters based on the review of selected engagement documentation and discussions with the engagement team. In reviewing the financial statements, the engagement quality reviewer may also become aware of other areas where significant judgments would have been expected to be made by the engagement team for which further information may be needed about the engagement team’s procedures or conclusions. The guidance in this paragraph also applies to reviews <u>of financial statements</u> and the related engagement report. (<u>Footnote 1</u>)</p> <p>A48. For engagements other than audits <u>or reviews</u> of financial statements, the engagement quality reviewer’s review of the engagement report and, when applicable, the subject matter information may include considerations similar to those described in paragraph A46 (for example, whether the presentation or description of matters relating to the significant judgments made by the engagement team are consistent with the engagement quality reviewer’s understanding based on the procedures performed in connection with the review). (<u>Footnote 2</u>)</p> <p><u>Footnote 1: Applicable Statements on Auditing Standards, including AU-C 930, Review of interim financial information.</u></p> <p><u>Footnote 2: Applicable Statements on Standards for Attestation Engagements, Statements on Standards for Accounting and Review Services.</u></p>	
104	65	QM2 AM\Yes	Yes	Noted
105	76	QM2 AM\Yes	Yes	Noted
106	102	QM2 AM\Yes	The application material in QM SAS is helpful. .	Noted
107	138	QM2 AM\Yes	Yes	Noted
108	156	QM2 AM\Yes	Yes, based on our initial reading of SQMS No. 2.	Noted
109	159	QM2 AM\Yes	Yes	Noted
110	162	QM2 AM\Yes	Yes, we believe the application material in SQMS No. 2 is clear and understandable.	Noted
111	164	QM2 AM\Yes	Yes, the application material is helpful.	Noted
112	168	QM2 AM\Yes	Yes, the application materials are helpful.	Noted

Agenda Item 4D – Detailed Comments QM 2

Row	CL #	Category	Coded Text	Task Force Comments
113	65	QM2 Other	With respect to threats to the objectivity of the engagement quality reviewer, there was nothing in the ED about “rotation”-i.e., limits on how long the same individual can serve as a reviewer on a particular engagement). My former firm has a rotation policy, longer for non-filers than for filers. The ASB should consider adding guidance concerning rotation to SQMS No. 2.	No change; no guidance around engagement partner rotation either.
114	134	QM2 Other	Separate standard Nevertheless, we do have some concerns with the geography of this proposed standard and the implications for firms’ implementation and subsequent evaluations, including conclusions related to deficiencies. We note that this proposed standard would no longer be part of US GAAS, which would be inconsistent with the PCAOB’s equivalent standard that currently resides in auditing standards, not in quality control standards. This may create implementation challenges for firms with regard to how EQ reviews fall into, and interact with, a firm’s overall system of quality management. In particular, guidance may be needed as to whether a departure from SQMS 2 might lead to a noncompliant engagement or to an issue with the firm’s system of quality management. It is currently unclear because EQ reviews are engagement-specific, but the proposed standard governing them resides within the standards on quality management. We believe this is another point of possible coordination with the PRB.	No change to standards. Agree that this is a point of coordination with the PRB.
115	146	QM2 Other	Yes, the materials are clear and understandable to us, but we have a concern that they will not be clear to smaller firms. We see many design deficiencies where firms do not understand engagement quality control review requirements as they are currently written. Additionally, firms that do not understand the requirements write their policies and procedures in such a way that none of their engagements ever meet the criteria.	No change to standard; address thru implementation guidance.



**Proposed Statement on Auditing Standards (SAS) *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***

**Introduction**

**Scope of This Proposed Statement on Auditing Standards**

1. This proposed Statement on Auditing Standards (SAS) addresses the specific responsibilities of the auditor regarding quality management at the engagement level for an audit of financial statements and the related responsibilities of the engagement partner. This proposed SAS also applies, adapted as necessary, to other engagements conducted in accordance with generally accepted auditing standards (GAAS) (for example, a review of interim financial information conducted in accordance with AU-C section 930, *Interim Financial Information*).<sup>□</sup> This proposed SAS is to be read in conjunction with the AICPA Code of Professional Conduct (AICPA code) and other relevant ethical requirements. (Ref: par. A1, A38)

2. Although government audit organizations are subject to the quality control and assurance requirements of Government Auditing Standards and Statements on Quality Management Standards (SQMSs) are not applicable to auditors in government audit organizations<sup>1</sup>, this proposed SAS is applicable to auditors in government audit organizations who perform financial audits in accordance with GAAS.

Commented [AG1]: To clarify as requested by NSAA.

**The Firm's System of Quality Management and Role of Engagement Teams**

3. Under proposed SQMS *A Firm's System of Quality Management* the objective of the firm is to design, implement, and operate a system of quality management for engagements performed by the firm in its accounting and auditing practice that provides the firm with reasonable assurance that (Ref: par. A2–A3)

- a. the firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements; and
- b. engagement reports issued by the firm or engagement partners are appropriate in the circumstances.<sup>2</sup>

4. The engagement team, led by the engagement partner, is responsible, within the context of the firm's system of quality management and through complying with the requirements of this proposed SAS, for the following: (Ref: par. A4–A11)

- a. Implementing the firm's responses to quality risks (that is, the firm's policies or procedures) that are applicable to the audit engagement using information communicated by, or obtained from, the firm

\* All AU-C sections can be found in AICPA *Professional Standards*.

<sup>1</sup> Paragraph 5 of proposed SQMS *A Firm's System of Quality Management*.

<sup>2</sup> Paragraph 15 of proposed SQMS *A Firm's System of Quality Management*.

- b. Given the nature and circumstances of the audit engagement, determining whether to design and implement responses at the engagement level beyond those in the firm's policies or procedures
- c. Communicating to the firm information from the audit engagement that is required to be communicated by the firm's policies or procedures to support the design, implementation, and operation of the firm's system of quality management.

5. Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. (Ref: par. A12)

6. The public interest is served by the consistent performance of quality audit engagements through achieving the objective of this proposed SAS and other AU-C sections for each engagement. A quality audit engagement is achieved through planning and performing the engagement and reporting on it in accordance with professional standards and applicable legal and regulatory requirements. Achieving the objectives of those standards and complying with the requirements of applicable law or regulation involves exercising professional judgment and ~~exercising-maintaining~~ professional skepticism.

**Commented [AG2]:** To be consistent with ASB style; see rows 74 and 79, item 4D

7. In accordance with AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*,<sup>3</sup> the engagement team is required to plan and perform an audit with professional skepticism and to exercise professional judgment. Professional judgment is exercised in making informed decisions about the courses of action that are appropriate to manage and achieve quality given the nature and circumstances of the audit engagement. Professional skepticism supports the quality of judgments made by the engagement team and, through these judgments, supports the overall effectiveness of the engagement team in achieving quality at the engagement level. The appropriate ~~exercise-maintenance~~ of professional skepticism may be demonstrated through the actions and communications of the engagement team. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate ~~exercise-maintenance~~ of professional skepticism, such as unconscious bias or resource constraints. (Ref: par. A33–A36)

#### **Scalability**

8. The requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each audit. Examples follow:

- When an audit is carried out entirely by the engagement partner, which may be the case for an audit of a less complex entity, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of other members of the engagement team. (Ref: par. A13–A14)
- When an audit is not carried out entirely by the engagement partner or in an audit of an entity whose nature and circumstances are more complex, the engagement partner may assign the design or performance of some procedures, tasks, or actions to other members of the engagement team.

<sup>3</sup> Paragraphs .17–.18 and .A22–.A31 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

### **The Engagement Partner's Responsibilities**

9. The engagement partner remains ultimately responsible and, therefore, accountable, for compliance with the requirements of this proposed SAS. The phrase “take responsibility for...” is used for those requirements for which the engagement partner is permitted to assign the design or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team. For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled by the engagement partner, and the engagement partner may obtain information from the firm or other members of the engagement team. (Ref: par. A22–A25)

### **Effective Date**

10. This proposed SAS is effective for engagements conducted in accordance with GAAS for periods beginning on or after [December 15, 2023].<sup>□</sup>

### **Objective**

11. The objective of the auditor is to manage quality at the engagement level to obtain reasonable assurance that quality has been achieved such that

- a. the auditor has fulfilled the auditor's responsibilities, and has conducted the audit, in accordance with professional standards and applicable legal and regulatory requirements; and
- b. the auditor's report issued is appropriate in the circumstances.

### **Definitions**

12. For purposes of GAAS, the following terms have the meanings attributed as follows:

**Engagement partner.**<sup>4</sup> The partner or other individual appointed by the firm, who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, when required, has the appropriate authority from a professional, legal, or regulatory body.

**Engagement quality review.** An objective evaluation of the significant judgments made by the engagement team and the conclusions reached thereon, performed by the engagement quality reviewer and completed ~~on or~~ before the ~~date of the~~ engagement report is released.

**Engagement quality reviewer.** A partner, other individual in the firm, or an external individual appointed by the firm to perform the engagement quality review.

**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 specialist<sup>5</sup> and internal auditors who provide direct assistance on an engagement.<sup>6</sup> (Ref: par. A15–A25)

**Firm.** A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and is engaged in public practice. (Ref: par. A26)

\* This date is provisional but will not be earlier than December 15, 2023.

<sup>4</sup> *Engagement partner*, *partner*, and *firm* refer to their governmental equivalents when relevant.

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

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

**Inspection.** ~~Inspection is a retrospective evaluation of the adequacy of the firm's quality management policies and procedures, its personnel's understanding of those policies and procedures, and the extent of the firm's compliance with them.~~

**Network.** An association of entities ~~that includes one or more firms~~, as defined in "Definitions" (ET section 0.400) in the AICPA ~~cCode of Professional Conduct~~. (Ref: par. A27)

**Network firm.** A firm or other entity that belongs to a network, as defined in "Definitions" (ET section 0.400) in the AICPA ~~cCode of Professional Conduct~~. References to a *network firm* are to be read hereafter as "another firm or entity that belongs to the same network as the firm." (Ref: par. A27)

**Partner.** Any individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, *partner* may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms might use different titles to refer to individuals with this authority.

**Personnel.** Partners and staff in the firm.

**Professional standards.** Standards promulgated by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under the "General Standards Rule" (ET sec. 1.300.001) or the "Compliance With Standards Rule" (ET sec. 1.310.001) of the AICPA ~~cCode of Professional Conduct~~, or other standard-setting bodies that set auditing and attest standards applicable to the engagement being performed and relevant ethical requirements.

**Relevant ethical requirements.** Principles of professional ethics and ethical requirements to which the engagement team and engagement quality reviewer are subject, which consist of the AICPA ~~cCode of Professional Conduct~~ together with rules of applicable state boards of accountancy and applicable regulatory agencies that are more restrictive.

**Response (in relation to a system of quality management).** Policies or procedures designed and implemented by the firm to address one or more quality risks:

- Policies are statements of what should, or should not, be done to address a quality risk or risks. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- Procedures are actions to implement policies.

**Staff.** Professionals, other than partners, including any specialist the firm employs.

## Requirements

### Leadership Responsibilities for Managing and Achieving Quality on Audits

13. The engagement partner should take overall responsibility for managing and achieving quality on the audit engagement, including taking responsibility for creating an environment for the engagement that emphasizes the firm's culture and expected behavior of engagement team members. In doing so, the engagement partner should be sufficiently and appropriately involved throughout the audit engagement such that the engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the engagement. (Ref: par. A28–A37)

14. In creating the environment described in paragraph 13, the engagement partner should take responsibility for clear, consistent, and effective actions being taken that reflect the firm's commitment to quality and that establish and communicate the expected behavior of engagement team members, including emphasizing the following: (Ref: par. A30–A34)

**Commented [AG3]:** Added per comment letter suggestion. In extant.

**Commented [AG4]:** To be more consistent with ET section 0.400.33 wording.

- a. That all engagement team members are responsible for contributing to the management and achievement of quality at the engagement level
- b. The importance of professional ethics, values, and attitudes to the members of the engagement team
- c. The importance of open and robust communication within the engagement team and supporting the ability of engagement team members to raise concerns without fear of reprisal
- d. The importance of each engagement team member ~~exercising~~ ~~maintaining~~ professional skepticism throughout the audit engagement

15. If the engagement partner assigns the design or performance of procedures, tasks, or actions related to a requirement of this proposed SAS to other members of the engagement team to assist the engagement partner in complying with the requirements of this proposed SAS, the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement through direction and supervision of those members of the engagement team and review of their work. (Ref: par. 9 and A37)

#### **Relevant Ethical Requirements, Including Those Related to Independence**

16. The engagement partner should have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: par. A38–A42 and A48)

17. The engagement partner should take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures, including those that address the following: (Ref: par. A23–A25 and A40–A44)

- a. Identifying, evaluating, and addressing threats to compliance with relevant ethical requirements, including those related to independence
- b. Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches
- c. The responsibilities of members of the engagement team when they become aware of an instance of noncompliance with laws and regulations by the entity<sup>7</sup>

18. If matters come to the engagement partner's attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner should evaluate the threats by complying with the firm's policies or procedures; using relevant information from the firm, the engagement team, or other sources; and take appropriate action. (Ref: par. A43–A44)

19. The engagement partner should remain alert throughout the audit engagement, through observation and making inquiries as necessary, for breaches of relevant ethical requirements or the firm's related policies or procedures by members of the engagement team. (Ref: par. A45)

20. If matters come to the engagement partner's attention through the firm's system of quality management, or from other sources, that indicate that relevant ethical requirements applicable to the nature

<sup>7</sup> See AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.

and circumstances of the audit engagement have not been fulfilled, the engagement partner, in consultation with others in the firm, should take appropriate action. (Ref: par. A46)

21. Prior to dating the auditor's report, the engagement partner should take responsibility for determining whether relevant ethical requirements, including those related to independence, have been fulfilled. (Ref: par. A38 and A47)

#### **Acceptance and Continuance of Client Relationships and Audit Engagements**

22. The engagement partner should determine that the firm's policies or procedures for the acceptance and continuance of client relationships and audit engagements have been followed, and that conclusions reached in this regard are appropriate. (Ref: par. A49–A52, A58)

23. The engagement partner should take into account information obtained in the acceptance and continuance process in planning and performing the audit engagement in accordance with GAAS and complying with the requirements of this proposed SAS. (Ref: par. A53–A56)

24. If the engagement team becomes aware of information that may have caused the firm to decline the audit engagement had that information been known by the firm prior to accepting or continuing the client relationship or specific engagement, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action. (Ref: par. A57)

#### **Engagement Resources**

25. The engagement partner should determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the audit engagement, the firm's policies or procedures, and any changes that may arise during the engagement. (Ref: par. A59–A70, A73–A74, and A79)

26. The engagement partner should determine that members of the engagement team, and any auditor's external specialists and internal auditors who provide direct assistance who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. (Ref: par. A62 and A71–A74)

27. If, as a result of complying with the requirements in paragraphs 25 and 26, the engagement partner determines that resources assigned or made available are insufficient or inappropriate in the circumstances of the audit engagement, the engagement partner should take appropriate action, including communicating with appropriate individuals about the need to assign or make available additional or alternative resources to the engagement. (Ref: par. A75–A78)

28. The engagement partner should take responsibility for using the resources assigned or made available to the engagement team appropriately, given the nature and circumstances of the audit engagement. (Ref: par. A63–A69)

#### **Engagement Performance**

##### ***Direction, Supervision, and Review***

29. The engagement partner should take responsibility for the direction and supervision of the members of the engagement team and the review of their work. (Ref: par. A80)

- 30.** The engagement partner should determine that the nature, timing, and extent of direction; supervision, and review is (Ref: par. A81–A89 and A94–A97)
- a. planned<sup>8</sup> and performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements, and
  - b. responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team by the firm.
- 31.** The engagement partner should review audit documentation at appropriate points in time during the audit engagement, including audit documentation relating to (Ref: par. A90–A93)
- a. significant matters;<sup>9</sup>
  - b. significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
  - c. other matters that, in the engagement partner’s professional judgment, are relevant to the engagement partner’s responsibilities.
- 32.** On or before the date of the auditor’s report, the engagement partner should determine, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor’s report to be issued. (Ref: par. A90–A94)
- 33.** Prior to dating the auditor’s report, the engagement partner should review the financial statements and the auditor’s report, including, if applicable, the description of the key audit matters<sup>10</sup> and related audit documentation, to determine that the report to be issued will be appropriate in the circumstances.<sup>11</sup>
- 34.** The engagement partner should review, prior to their issuance, formal written communications to management, those charged with governance, or regulatory authorities. (Ref: par. A98)

**Consultation**

- 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,

<sup>8</sup> Paragraph .11 of AU-C section 300, *Planning an Audit of Financial Statements*.

<sup>9</sup> Paragraph .08 of AU-C section 230, *Audit Documentation*.

<sup>10</sup> See AU-C section 701, *Communicating Key Audit Matters in the Auditor’s Report*.

<sup>11</sup> See AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, or AU-C section 705, *Modifications to the Opinion in the Independent Auditor’s Report*.

- 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.

#### **Engagement Quality Review**

36. For audit engagements for which an engagement quality review is required, the engagement partner should (Ref: par. A103)

- a. determine that an engagement quality reviewer has been appointed,
- b. cooperate with the engagement quality reviewer and inform other members of the engagement team of their responsibility to do so,
- c. discuss significant matters and significant judgments arising during the audit engagement, including those identified during the engagement quality review, with the engagement quality reviewer, and
- d. not ~~date~~ release the auditor's report until the completion of the engagement quality review. (Ref: par. A104–A106)

Commented [AG5]: To conform with extant

#### **Differences of Opinion**

37. If differences of opinion arise within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management, including those who provide consultation, the engagement team should follow the firm's policies or procedures for dealing with and resolving such differences of opinion. (Ref: par. A107–A108)

38. The engagement partner should

- a. take responsibility for differences of opinion being addressed and resolved in accordance with the firm's policies or procedures,
- b. determine that conclusions reached are documented and implemented, and
- c. not date the auditor's report until any differences of opinion are resolved.

#### **Monitoring and Remediation**

39. The engagement partner should take responsibility for the following: (Ref: par. A109–A112)

- a. Obtaining an understanding of the information from the firm's monitoring and remediation process, as communicated by the firm, including, as applicable, the information from the monitoring and remediation process of the network and across the network firms
- b. Determining the relevance and effect on the audit engagement of the information referred to in paragraph 39a and take appropriate action
- c. Remaining alert throughout the audit engagement for information that may be relevant to the firm's monitoring and remediation process and communicate such information to those responsible for the process

### **Taking Overall Responsibility for Managing and Achieving Quality**

**40.** Prior to dating the auditor's report, the engagement partner should determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. In doing so, the engagement partner should determine that (Ref: par. A113–A116)

- the engagement partner's involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement; and
- the nature and circumstances of the audit engagement, any changes thereto, and the firm's related policies or procedures have been taken into account in complying with the requirements of this proposed SAS.

### **Documentation**

**41.** In applying AU-C section 230, *Audit Documentation*, the auditor should include the following in the audit documentation:<sup>12</sup> (Ref: par. A117–A120)

- a. Significant issues identified, relevant discussions with personnel, and conclusions reached with respect to
  - i. fulfillment of responsibilities relating to relevant ethical requirements, including those related to independence
  - ii. the acceptance and continuance of the client relationship and audit engagement
- b. The nature and scope of, and conclusions resulting from, consultations undertaken during the audit engagement and how such conclusions were implemented
- c. If the audit engagement is subject to an engagement quality review, that the engagement quality review has been completed ~~on or~~ before the ~~date~~ release of the auditor's report

### **Application and Other Explanatory Material**

#### **Scope of This Proposed SAS (Ref: par. 1)**

**A1.** This proposed SAS applies to all audits of financial statements, including audits of group financial statements. AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*, deals with special considerations that apply to an audit of group financial statements, including when component auditors are involved. AU-C section 600 also provides guidance on how to adapt and apply the requirements of this proposed SAS in an audit of group financial statements involving component auditors. AU-C section 600, adapted as necessary in the circumstances, may also be useful in an audit of financial statements when the engagement team includes individuals from another firm. For example, AU-C section 600 may be useful when involving such an individual to attend a physical inventory count; inspect property, plant, and equipment; or perform audit procedures at a shared service center at a remote location.

#### **The Firm's System of Quality Management and Role of Engagement Teams (Ref: par. 3–9)**

**A2.** Proposed SQMS *A Firm's System of Quality Management* addresses a firm's responsibilities for designing, implementing, and operating its system of quality management.

<sup>12</sup> Paragraphs .08–.11 of AU-C section 230.

**A3.** Firms may use different terminology or frameworks to describe the components of the system of quality management.

***The Engagement Team’s Responsibilities Relating to the Firm’s System of Quality Management (Ref: par. 4)***

**A4.** Quality management at the engagement level is supported by the firm’s system of quality management and informed by the specific nature and circumstances of the audit engagement. In accordance with proposed SQMS A *Firm’s System of Quality Management*, the firm is responsible for communicating information that enables the engagement team to understand and carry out their responsibilities relating to performing engagements. For example, such communications may cover policies or procedures to undertake consultations with designated individuals in certain situations involving complex technical or ethical matters or to involve firm-designated experts in specific engagements to perform audit procedures related to particular matters (for example, the firm may specify that firm-designated credit-risk modeling experts are to be involved in auditing expected credit loss allowances in audits of financial institutions).

**A5.** Firm-level responses may include policies or procedures established by a network or by other firms, structures, or organizations within the same network (network requirements or network services are described further in proposed SQMS A *Firm’s System of Quality Management* within the “Network Requirements or Network Services” section).<sup>13</sup> The requirements of this proposed SAS are based on the premise that the firm is responsible for taking the necessary action to enable engagement teams to implement or use network requirements or network services on the audit engagement (for example, a requirement to use an audit methodology developed for use by a network firm). Under proposed SQMS A *Firm’s System of Quality Management*, the firm is responsible for determining how network requirements or network services are relevant to, and are taken into account in, the firm’s system of quality management.<sup>14</sup>

**A6.** Some firm-level responses to quality risks are not performed at the engagement level but are, nevertheless, relevant when complying with the requirements of this proposed SAS. For example, firm-level responses that the engagement team may be able to depend on when complying with the requirements of this proposed SAS include

- personnel recruitment and professional training processes,
- the IT applications that support the firm’s monitoring of independence,
- the development of IT applications that support the acceptance and continuance of client relationships and audit engagements, and
- the development of audit methodologies and related implementation tools and guidance.

**A7.** Due to the specific nature and circumstances of each audit engagement and changes that may occur during the audit engagement, a firm cannot identify all quality risks that may arise at the engagement level or set forth all relevant and appropriate responses. Accordingly, the engagement team exercises

<sup>13</sup> Paragraph 50b of proposed SQMS A *Firm’s System of Quality Management*.

<sup>14</sup> Paragraph 50a of proposed SQMS A *Firm’s System of Quality Management*.

professional judgment in determining whether to design and implement responses, beyond those set forth in the firm's policies or procedures, at the engagement level to meet the objective of this proposed SAS.<sup>15</sup>

**A8.** The engagement team's determination of whether engagement-level responses are necessary (and, if so, what those responses are) is influenced by the requirements of this proposed SAS, the engagement team's understanding of the nature and circumstances of the engagement, and any changes during the audit engagement. For example, unanticipated circumstances may arise during the engagement that may cause the engagement partner to request the involvement of appropriately experienced personnel in addition to those initially assigned or made available by the firm.

**A9.** The relative balance of the engagement team's efforts to comply with the requirements of this proposed SAS (that is, between implementing the firm's responses and designing and implementing engagement-specific responses beyond those set forth in the firm's policies or procedures) may vary. For example, the firm may design an audit program to be used in circumstances that are applicable to the audit engagement (for example, an industry-specific audit program). Other than determining the timing and extent of procedures to be performed, there may be little or no need for supplemental audit procedures to be added to the audit program at the engagement level. Alternatively, the engagement team's actions in complying with the engagement performance requirements of this proposed SAS may be more focused on designing and implementing responses at the engagement level to deal with the specific nature and circumstances of the engagement (for example, planning and performing procedures to address risks of material misstatement not contemplated by the firm's audit programs).

**A10.** Ordinarily, the engagement team may depend on the firm's policies or procedures in complying with the requirements of this proposed SAS, unless

- the engagement team's understanding or practical experience indicates that the firm's policies or procedures will not effectively address the nature and circumstances of the engagement, or
- information provided by the firm or other parties, about the effectiveness of such policies or procedures suggests otherwise (for example, information provided by the firm's monitoring activities, external inspections, or other relevant sources indicates that the firm's policies or procedures are not operating effectively).

**A11.** If the engagement partner becomes aware (including by being informed by other members of the engagement team) that the firm's responses to quality risks are ineffective in the context of the specific engagement or the engagement partner is unable to depend on the firm's policies or procedures, the engagement partner communicates such information promptly to the firm in accordance with paragraph 39c because such information is relevant to the firm's monitoring and remediation process. For example, if an engagement team member identifies that an audit software program has a security weakness, timely communication of such information to the appropriate personnel enables the firm to take steps to update and reissue the audit program. See also paragraph A69 in respect of sufficient and appropriate resources.

***Information Relevant to Quality Management at the Engagement Level (Ref: par. 5)***

**A12.** Complying with the requirements in other AU-C sections may provide information that is relevant to quality management at the engagement level. For example, the understanding of the entity and its

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<sup>15</sup> AU-C section 200 requires the auditor to exercise professional judgment in planning and performing an audit of financial statements.

environment required to be obtained under AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides information that may be relevant to complying with the requirements of this proposed SAS. Such information may be relevant to the determination of one or more of the following:

- The nature of resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts to deal with complex matters
- The amount of resources to allocate to specific audit areas, such as the number of team members assigned to attend the physical inventory count at multiple locations
- The nature, timing, and extent of review of the work performed by members of the team based on the assessed risks of material misstatement
- The allocation of the budgeted audit hours, including allocating more time, and the time of more experienced engagement team members to those areas where there are more risks of material misstatement or the identified risks are assessed as higher

**Scalability (Ref: par. 8)**

**A13.** In a smaller firm, the firm's policies or procedures may designate an engagement partner or partners, on behalf of the firm, to design many of the responses to the firm's quality risks because doing so may be a more effective approach to designing and implementing responses as part of the firm's system of quality management. Additionally, a smaller firm's policies or procedures may be less formal. For example, in a very small firm with a relatively small number of audit engagements, the firm may determine that there is no need to establish a firm-wide system to monitor independence and, rather, independence will be monitored at the individual engagement level by the engagement partner.

**A14.** The requirements relating to direction, supervision, and review of the work of other members of the engagement team are only relevant if there are members of the engagement team other than the engagement partner.

**Definitions**

**Engagement Team (Ref: par. 12d)**

**A15.** The engagement team may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations and may be organized in groups by the activity they are performing. Regardless of how the engagement team is organized, any individual who performs audit procedures<sup>16</sup> on the audit engagement, excluding an auditor's external specialist<sup>17</sup> and internal auditors who provide direct assistance on an engagement,<sup>18</sup> is a member of the engagement team.

**A16.** The definition of an *engagement team* focuses on individuals who perform audit procedures on the audit engagement. *Audit evidence*, which is necessary to support the auditor's opinion and report, is primarily obtained from audit procedures performed during the course of the audit.<sup>19</sup> Audit procedures

<sup>16</sup> Paragraph .A44 of AU-C section 500, *Audit Evidence*.

<sup>17</sup> Paragraph .06 of AU-C section 620 defines the term *auditor's specialist*.

<sup>18</sup> AU-C section 610 establishes limits on the use of direct assistance.

<sup>19</sup> Paragraph .A32 of AU-C section 200.

comprise risk assessment procedures<sup>20</sup> and further audit procedures.<sup>21</sup> As explained in AU-C section 500, *Audit Evidence*, audit procedures include inspection, observation, confirmation, recalculation, reperformance, analytical procedures, and inquiry, often performed in some combination.<sup>22</sup> Other AU-C sections may also include specific procedures to obtain audit evidence, for example, AU-C section 520, *Analytical Procedures*.

**A17.** Engagement teams include personnel and may also include other individuals who perform audit procedures who are from

- a network firm, or
- a firm that is not a network firm or another service provider.<sup>23</sup>

For example, an individual from another firm may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count, or inspect physical fixed assets at a remote location.

**A18.** Engagement teams may also include individuals from service delivery centers who perform audit procedures. For example, it may be determined that specific tasks that are repetitive or specialized in nature will be performed by a group of appropriately skilled personnel; thus, the engagement team includes such individuals. Service delivery centers may be established by the firm, the network, or by other firms, structures, or organizations within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.

**A19.** Engagement teams may include individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes or in analyzing complex information produced by automated tools and techniques for the purpose of identifying unusual or unexpected relationships. An individual is not a member of the engagement team if that individual's involvement with the engagement is limited to consultation. Consultations are addressed in paragraphs 35 and A99–A102.

**A20.** If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and any other individuals performing the engagement quality review, are not members of the engagement team. Such individuals may be subject to specific independence requirements.

**A21.** An internal auditor providing direct assistance and an auditor's external specialist whose work is used in the engagement are not members of the engagement team.<sup>24</sup> AU-C sections 610, *Using the Work of Internal Auditors*, and 620, *Using the Work of an Auditor's Specialist*, provide requirements and guidance for the auditor when using the work of internal auditors in a direct assistance capacity or when using the work of an external specialist, respectively. Compliance with these AU-C sections requires the auditor to obtain sufficient appropriate audit evidence on the work performed by an internal auditor who is providing direct assistance and perform audit procedures on the work of an auditor's specialist.

***The Engagement Partner's Responsibilities (Ref: par. 9, 12d)***

**A22.** When this proposed SAS expressly intends that a requirement or responsibility be fulfilled by the engagement partner, the engagement partner may need to obtain information from the firm or other members of the engagement team to fulfill the requirement (for example, information to make the required

<sup>20</sup> AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, provides requirements related to risk assessment procedures.

<sup>21</sup> AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, provides requirements related to further audit procedures, including tests of controls and substantive procedures.

<sup>22</sup> Paragraph .A43 of AU-C section 500.

<sup>23</sup> Paragraph 17v of proposed SQMS *A Firm's System of Quality Management*.

<sup>24</sup> See paragraphs .12–.13 of AU-C section 620 and paragraphs .20–.24 of AU-C section 610.

decision or judgment). For example, the engagement partner is required to determine that members of the engagement team collectively have the appropriate competence and capabilities to perform the audit engagement. To make a judgment on whether the competence and capabilities of the engagement team is appropriate, the engagement partner may need to use information compiled by the engagement team or from the firm's system of quality management.

***The Application of Firm Policies or Procedures by Members of the Engagement Team (Ref: par. 8)***

**A23.** Within the context of the firm's system of quality management, engagement team members from the firm are responsible for implementing the firm's policies or procedures that are applicable to the audit engagement. Engagement team members from another firm are neither partners nor staff of the engagement partner's firm. As such, they may not be subject to the firm's system of quality management or the firm's policies or procedures. Further, the policies or procedures of another firm may not be similar to that of the engagement partner's firm. For example, policies or procedures regarding direction, supervision, and review may be different, particularly when the other firm is in a jurisdiction with a different legal system, language, or culture than that of the engagement partner's firm. Accordingly, when the engagement team includes individuals who are from another firm, different actions may need to be taken by the firm or the engagement partner to implement the firm's policies or procedures with respect to the work of those individuals.

**A24.** In particular, the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether an individual from another firm

- has the appropriate competence and capabilities to perform the audit engagement. For example, the individual would not be subject to the firm's recruitment and training processes and, therefore, the firm's policies or procedures may state that this determination can be made through other actions such as obtaining information from the other firm or a licensing or oversight body. Paragraphs 22 and A47–A48 of AU-C section 600 contain guidance on obtaining an understanding of the competence and capabilities of component auditors.
- understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm's training with regard to the firm's policies or procedures for relevant ethical requirements. The firm's policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals, or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement to the individual.
- will confirm independence. For example, individuals who are not personnel may not be able to complete independence declarations directly on the firm's independence systems. The firm's policies or procedures may state that such individuals can provide evidence of their independence in relation to the audit engagement in other ways, such as written confirmation.

**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.

***Firm (Ref: par. 12e)***

**A26.** The definition of *firm* in relevant ethical requirements may differ from the definition set out in this proposed SAS.

**“Network” and “Network Firm” (Ref: par. 12f–g)**

**A27.** The definitions of *network* or *network firm* in relevant ethical requirements may differ from those set out in this proposed SAS. The AICPA code also provides guidance in relation to the terms *network* and *network firm*. Networks and other network firms may be structured in a variety of ways and are in all cases external to the firm. The provisions in this proposed SAS in relation to networks also apply to any structures or organizations that do not form part of the firm but that exist within the network.

**Leadership Responsibilities for Managing and Achieving Quality in Audits (Ref: par. 13–15)**

***Taking Overall Responsibility for Managing and Achieving Quality***

**A28.** Proposed SQMS A *Firm’s System of Quality Management* requires the firm to establish quality objectives that address the firm’s governance and leadership that supports the design, implementation, and operation of the system of quality management. The engagement partner’s responsibility for managing and achieving quality is supported by a firm culture that demonstrates a commitment to quality. In addressing the requirements in paragraphs 13 and 14 of this proposed SAS, the engagement partner may communicate directly to other members of the engagement team and reinforce this communication through personal conduct and actions (for example, leading by example). A culture that demonstrates a commitment to quality is further shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement.

***Scalability***

**A29.** The nature and extent of the actions of the engagement partner to demonstrate the firm’s commitment to quality may depend on a variety of factors, including the size, structure, geographical dispersion, and complexity of the firm and the engagement team and the nature and circumstances of the audit engagement. With a smaller engagement team with few engagement team members, influencing the desired culture through direct interaction and conduct may be sufficient, whereas for a larger engagement team that is dispersed over many locations, more formal communications may be necessary.

***Sufficient and Appropriate Involvement***

**A30.** Being sufficiently and appropriately involved throughout the audit engagement may be demonstrated by the engagement partner in different ways, including the following:

- Taking responsibility for the nature, timing, and extent of the direction and supervision of the members of the engagement team and the review of their work in complying with the requirements of this proposed SAS
- Varying the nature, timing, and extent of such direction, supervision, and review in the context of the nature and circumstances of the engagement

***Communication***

**A31.** Communication is the means through which the engagement team shares relevant information on a timely basis to comply with the requirements of this proposed SAS, thereby contributing to the achievement of quality on the audit engagement. Communication may be between or among members of the engagement team or with

- a. the firm, (for example, individuals performing activities within the firm’s system of quality management, including those assigned ultimate or operational responsibility for the firm’s system of quality management),

- b. others involved in the audit (for example, internal auditors who provide direct assistance<sup>25</sup> or an auditor's external specialist<sup>26</sup>), and
- c. parties that are external to the firm (for example, management, those charged with governance, or regulatory authorities).

**A32.** The nature and circumstances of the audit engagement may affect the engagement partner's decisions regarding the appropriate means of effective communication with the members of the engagement team. For example, to support appropriate direction, supervision, and review, the firm may use IT applications to facilitate the communication between the members of the engagement team when they are performing work across different geographical locations.

**Professional Skepticism (Ref: par. 7)**

**A33.** The engagement partner is responsible for emphasizing the importance of each engagement team member ~~exercising~~maintaining professional skepticism throughout the audit engagement. Conditions inherent in some audit engagements can create pressures on the engagement team that may impede the appropriate exercise of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Accordingly, when developing the overall audit strategy in accordance with AU-C section 300, *Planning an Audit*, the engagement team may need to consider whether such conditions exist in the audit engagement and, if so, what actions the firm or the engagement team may need to undertake to mitigate such impediments.

**A34.** Impediments to the exercise of professional skepticism at the engagement level may include the following:

- Budget constraints, which may discourage the use of sufficiently experienced or technically qualified resources, including experts, necessary for audits of entities in which technical expertise or specialized skills are needed for effective understanding, assessment of, and responses to risks and informed questioning of management.
- Tight deadlines, which may negatively affect the behavior of those who perform the work as well as those who direct, supervise, and review. For example, external time pressures may create restrictions to analyzing complex information effectively.
- Lack of cooperation or undue pressures imposed by management, which may negatively affect the engagement team's ability to resolve complex or contentious issues.
- Insufficient understanding of the entity and its environment, its system of internal control, and the applicable financial reporting framework, which may constrain the ability of the engagement team to make appropriate judgments and an informed questioning of management's assertions.
- Difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others, which may cause the engagement team to bias the selection of sources of audit evidence and seek audit evidence from sources that are more easily accessible.
- Overreliance on automated tools and techniques, which may result in the engagement team not critically assessing audit evidence.

**A35.** Unconscious or conscious auditor biases may affect the engagement team's professional judgments, including, for example, in the design and performance of audit procedures, or the evaluation of

<sup>25</sup> See paragraph .A47 of AU-C section 610.

<sup>26</sup> See paragraphs .11c and .A33 of AU-C section 620.

audit evidence. Examples of unconscious auditor biases that may impede the exercise of professional skepticism and, therefore, the reasonableness of the professional judgments made by the engagement team in complying with the requirements of this proposed SAS, may include the following:

- *Availability bias*, which is a tendency to place more weight on events or experiences that immediately come to mind or are readily available than on those that are not
- *Confirmation bias*, which is a tendency to place more weight on information that corroborates an existing belief than information that contradicts or casts doubt on that belief
- *Groupthink*, which is a tendency to think or make decisions as a group that discourages creativity or individual responsibility
- *Overconfidence bias*, which is a tendency to overestimate one's own ability to make accurate assessments of risk or other judgments or decisions
- *Anchoring bias*, which is a tendency to use an initial piece of information as an anchor against which subsequent information is inadequately assessed
- *Automation bias*, which is a tendency to favor output generated from automated systems, even when human reasoning or contradictory information raises questions about whether such output is reliable or fit for purpose.

**A36.** Possible actions that the engagement team may take to mitigate impediments to the exercise of professional skepticism at the engagement level may include the following:

- Remaining alert to changes in the nature or circumstances of the audit engagement that necessitate additional or different resources for the engagement and requesting additional or different resources from those individuals within the firm responsible for allocating or assigning resources to the engagement
- Explicitly alerting the engagement team to instances or situations in which vulnerability to unconscious or conscious auditor biases may be greater (for example, areas involving greater judgment) and emphasizing the importance of seeking advice from more experienced members of the engagement team in planning and performing audit procedures
- Changing the composition of the engagement team, for example, requesting that more experienced individuals with greater skills or knowledge or specific expertise are assigned to the engagement
- Involving more experienced members of the engagement team when dealing with members of management who are difficult or challenging to interact with
- Involving members of the engagement team with specialized skills and knowledge or an auditor's expert to assist the engagement team with complex or subjective areas of the audit
- Modifying the nature, timing, and extent of direction, supervision, or review by involving more experienced engagement team members, more in-person oversight on a more frequent basis, or more in-depth reviews of certain working papers for
  - complex or subjective areas of the audit;
  - areas that pose risks to achieving quality on the audit engagement;
  - areas with a fraud risk; and

- identified or suspected noncompliance with laws or regulations
- Setting expectations for
  - less experienced members of the engagement team to seek advice frequently and in a timely manner from more experienced engagement team members or the engagement partner, and
  - more experienced members of the engagement team to be available to less experienced members of the engagement team throughout the audit engagement and to respond positively and in a timely manner to their insights, requests for advice, or assistance
- Communicating with those charged with governance when management imposes undue pressure, or the engagement team experiences difficulties in obtaining access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence may be sought

**Assigning Procedures, Tasks, or Actions to Other Members of the Engagement Team (Ref: par. 15)**

**A37.** Being sufficiently and appropriately involved throughout the audit engagement when procedures, tasks, or actions have been assigned to other members of the engagement team may be demonstrated by the engagement partner in different ways, including the following:

- Informing assignees about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof, and to provide any other necessary instructions and relevant information
- Direction and supervision of the assignees
- Review of the assignees' work to evaluate the conclusions reached, in addition to the requirements in paragraphs 29–34

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. 16–21)

**Relevant Ethical Requirements (Ref: par. 1, 16–21)**

**A38.** AU-C section 200<sup>27</sup> requires that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, certain requirements related to independence may be applicable only when performing audits of listed entities, depository institutions, or employee benefit plans. AU-C section 600 includes additional requirements and guidance to those in this proposed SAS regarding communications about relevant ethical requirements with component auditors.

Commented [AG6]: Changed to relevant example

**A39.** Based on the nature and circumstances of the audit engagement, certain law, regulation, or aspects of relevant ethical requirements, such as those pertaining to noncompliance with laws or regulations, may be relevant to the engagement (for example, laws or regulations dealing with money laundering, corruption, or bribery).

<sup>27</sup> Paragraphs .16 and .A15–.A21 of AU-C section 200.

**A40.** The firm's information system and the resources provided by the firm may assist the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement. For example, the firm may do the following:

- Communicate the independence requirements to engagement teams
- Provide training for engagement teams on relevant ethical requirements
- Establish manuals and guides (that is, intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the nature and circumstances of the firm and its engagements
- Assign personnel to manage and monitor compliance with relevant ethical requirements (for example, proposed SQMS *A Firm's System of Quality Management* requires that the firm obtains, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or provide consultation on matters related to relevant ethical requirements
- Establish policies or procedures for engagement team members to communicate relevant and reliable information to appropriate parties within the firm or to the engagement partner, such as policies or procedures for engagement teams to
  - communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter
  - communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and, if it is not, address the threat by eliminating it or reducing it to an acceptable level
  - promptly communicate any breaches of the relevant ethical requirements, including those related to independence

**A41.** The engagement partner may take into account the information, communication, and resources described in paragraph A39 when determining whether the engagement partner may depend on the firm's policies or procedures in complying with relevant ethical requirements.

**A42.** Open and robust communication between the members of the engagement team about relevant ethical requirements may also assist in

- drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement, and
- keeping the engagement partner informed about matters relevant to the engagement team's understanding and fulfillment of relevant ethical requirements and the firm's related policies or procedures.

***Identifying and Evaluating Threats to Compliance With Relevant Ethical Requirements (Ref: par. 17–18)***

**A43.** In accordance with proposed SQMS *A Firm's System of Quality Management*, the firm's responses to address the quality risks in relation to relevant ethical requirements, including those related to

independence for engagement team members, include policies or procedures for identifying, evaluating, and addressing threats to compliance with the relevant ethical requirements.

**A44.** Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they are to be dealt with. For example, the AICPA code [ET section 1.295.040] provides safeguards for reducing threats to independence to an acceptable level when performing nonattest services to an attest client.

**Commented [AG7]:** To replace deleted example from IESBA Code.

*Breaches of Relevant Ethical Requirements (Ref: par. 19)*

**A45.** In accordance with proposed SQMS *A Firm's System of Quality Management*, the firm is required to establish policies or procedures for identifying, communicating, evaluating, and reporting of any breaches of relevant ethical requirements and appropriately responding to the causes and consequences of the breaches in a timely manner.

**Taking Appropriate Action (Ref: par. 20)**

**A46.** Examples of appropriate actions may include the following:

- Following the firm's policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate individuals so that appropriate action can be taken, including as applicable, disciplinary action.
- Communicating with those charged with governance.
- Communicating with regulatory authorities or professional bodies. In some circumstances, communication with regulatory authorities may be required by law or regulation.
- Seeking legal advice.
- Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

**Prior to Dating the Auditor's Report (Ref: par. 21)**

**A47.** AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, requires that the auditor's report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and that the auditor has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.<sup>28</sup> Performing the procedures required by paragraphs 16–21 of this proposed SAS provides the basis for these statements in the auditor's report.

**Considerations Specific to Governmental Audit Organizations**

**A48.** Law or regulation may provide safeguards for the independence of governmental audit organizations and the auditors they employ. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor's report the circumstances affecting the auditor's independence.

**Acceptance and Continuance of Client Relationships and Audit Engagements (Ref: par. 22–24)**

**A49.** Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish quality objectives that address the acceptance and continuance of client relationships and specific engagements.

<sup>28</sup> Paragraph .28c of AU-C section 700.

**A50.** Information such as the following may assist the engagement partner in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate:

- The integrity and ethical values of the principal owners, key management, and those charged with governance of the entity
- Whether sufficient and appropriate resources are available to perform the engagement
- Whether management and those charged with governance have acknowledged their responsibilities in relation to the engagement
- Whether the engagement team has the competence and capabilities, including sufficient time, to perform the engagement
- Whether significant matters that have arisen during the current or previous engagement have implications for continuing the engagement

**A51.** Under proposed SQMS A *Firm's System of Quality Management*, for acceptance and continuance decisions, the firm is required to make judgments about the firm's ability to perform the engagement in accordance with professional standards and applicable legal and regulatory requirements. The engagement partner may use the information considered by the firm in this regard in determining whether the conclusions reached regarding the acceptance and continuance of client relationships and audit engagements are appropriate. If the engagement partner has concerns regarding the appropriateness of the conclusions reached, the engagement partner may discuss the basis for those conclusions with those involved in the acceptance and continuance process.

**A52.** If the engagement partner is directly involved throughout the firm's acceptance and continuance process, the engagement partner will be aware of the information obtained or used by the firm in reaching the related conclusions. Such direct involvement may also provide a basis for the engagement partner's determination that the firm's policies or procedures have been followed and that the conclusions reached are appropriate.

**A53.** Information obtained during the acceptance and continuance process may assist the engagement partner in complying with the requirements of this proposed SAS and making informed decisions about appropriate courses of action. Such information may include the following:

- Information about the size, complexity, and nature of the entity, including whether it is a group audit, the industry in which it operates, and the applicable financial reporting framework
- The entity's timetable for reporting, such as at interim and final stages
- In relation to group audits, the nature of the control relationships between the parent and its components
- Whether there have been changes in the entity or in the industry in which the entity operates since the previous audit engagement that may affect the nature of resources required, as well as the manner in which the work of the engagement team will be directed, supervised, and reviewed

**A54.** Information obtained during acceptance and continuance may also be relevant in complying with the requirements of other AU-C sections, as well as this proposed SAS, for example, with respect to the following:

- Establishing an understanding of the terms of the audit engagement, as required by AU-C section 210, *Terms of Engagement*<sup>29</sup>
- Identifying and assessing risks of material misstatement, whether due to error or fraud, in accordance with AU-C section 315 and AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*
- Understanding the group, its components, and their environments, in the case of an audit of group financial statements in accordance with AU-C section 600, and directing, supervising, and reviewing the work of component auditors
- Determining whether, and how, to involve an auditor's specialist in accordance with AU-C section 620
- The entity's governance structure in accordance with AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, and AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*

**A55.** Law, regulation, or relevant ethical requirements may require the successor auditor to request, prior to accepting the audit engagement, the predecessor auditor to provide known information regarding any facts or circumstances that, in the predecessor auditor's judgment, the successor auditor needs to be aware of before deciding whether to accept the engagement. In some circumstances, the predecessor auditor may be required, on request by the proposed successor auditor, to provide information regarding identified or suspected noncompliance with laws and regulations to the proposed successor auditor.

**A56.** In circumstances when the firm is obligated by law or regulation to accept or continue an audit engagement, the engagement partner may take into account information obtained by the firm about the nature and circumstances of the engagement.

**A57.** In deciding on the necessary action, the engagement partner and the firm may conclude that it is appropriate to continue with the audit engagement and, if so, determine what additional steps are necessary at the engagement level (for example, the assignment of more staff or staff with specific expertise). If the engagement partner has further concerns or is not satisfied that the matter has been appropriately resolved, the firm's policies or procedures for resolving differences of opinion may be applicable.

***Considerations Specific to Governmental Audit Organizations (Ref: par. 22–24)***

**A58.** When the auditor is a government audit organization, the auditor may be appointed in accordance with law or regulation, and the auditor may not need to establish all policies or procedures regarding the acceptance and continuance of audit engagements. Nevertheless, the requirements and considerations for the acceptance and continuance of client relationships and engagements as set out in paragraphs 22–24 and A48–A56 may be valuable to such auditors in performing risk assessments and in carrying out reporting responsibilities.

***Engagement Resources (Ref: par. 25–28)***

**A59.** Under proposed SQMS *A Firm's System of Quality Management*, the resources assigned or made available by the firm to support the performance of audit engagements include

- human resources,
- technological resources, and
- intellectual resources.

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<sup>29</sup> Paragraph .09 of AU-C section 210, *Terms of Engagement*.

**A60.** Resources for an audit engagement are primarily assigned or made available by the firm, although there may be circumstances when the engagement team directly obtains resources for the audit engagement. For example, this may be the case when a component auditor is required by statute, regulation, or for another reason to express an audit opinion on the financial statements of a component, and the component auditor is also appointed by component management to perform audit procedures on behalf of the group engagement team.<sup>30</sup> In such circumstances, the firm's policies or procedures may require the engagement partner to take different actions, such as requesting information from the component auditor, to determine whether sufficient and appropriate resources are assigned or made available.

**A61.** A relevant consideration for the engagement partner, in complying with the requirements in paragraphs 25 and 26, may be whether the resources assigned or made available to the engagement team enable fulfillment of relevant ethical requirements, including ethical principles such as professional competence and due care.

#### **Human Resources**

**A62.** Human resources include members of the engagement team (see also paragraphs A5 and A15–A21) and, when applicable, an auditor's external specialist and individuals from within the entity's internal audit function who provide direct assistance on the audit.

#### **Technological Resources**

**A63.** The use of technological resources on the audit engagement may assist the auditor in obtaining sufficient appropriate audit evidence. Technological resources may include tools that allow the auditor to more effectively and efficiently manage the audit. Technological tools may also allow the auditor to evaluate large amounts of data more easily to, for example, provide deeper insights, identify unusual trends, or more effectively challenge management's assertions, which enhances the ability of the auditor to exercise professional skepticism. Technological tools may also be used to conduct meetings and provide communication tools to the engagement team. Inappropriate use of technological resources may, however, increase the risk of overreliance on the information produced for decision-making purposes or may create threats to complying with relevant ethical requirements, for example, requirements related to confidentiality.

**A64.** The firm's policies or procedures may include required considerations or responsibilities for the engagement team when using firm-approved technological tools to perform audit procedures and may require, depending on the tool used, the involvement of individuals with specialized skills or expertise in evaluating or analyzing the output.

**A65.** When the engagement partner requires individuals from another firm to use specific automated tools and techniques when performing audit procedures, communications with those individuals may indicate that the use of such automated tools and techniques needs to comply with the engagement team's instructions.

**A66.** The firm's policies or procedures may specifically prohibit the use of certain IT applications or features of IT applications (for example, software that has not yet been specifically approved for use by the firm). Alternatively, the firm's policies or procedures may require the engagement team to take certain actions before using an IT application that is not firm-approved to determine it is appropriate for use, for example, by requiring

- the engagement team to have appropriate competence and capabilities to use the technological resource.
- testing of the operation and security of the IT application.
- specific documentation to be included in the audit file.

<sup>30</sup> See paragraph .03 of AU-C section 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*.

**A67.** The engagement partner may exercise professional judgment in considering whether the use of an IT application on the audit engagement is appropriate in the context of the engagement, and if so, how the IT application is to be used. Factors that may be considered in determining whether a particular IT application that has not been specifically approved for use by the firm is appropriate for use in the audit engagement include whether

- use and security of the IT application complies with the firm's policies or procedures.
- the IT application operates as intended.
- personnel have the competence and capabilities required to use the IT application.

#### ***Intellectual Resources***

**A68.** Intellectual resources include, for example, audit methodologies, implementation tools, auditing guides, model programs, templates, checklists, or forms.

**A69.** The use of intellectual resources on the audit engagement may facilitate the consistent application and understanding of professional standards, law and regulation, and related firm policies or procedures. For this purpose, the engagement team may be required, in accordance with the firm's policies or procedures, to use the firm's audit methodology and specific tools and guidance. The engagement team may also consider whether the use of other intellectual resources is appropriate and relevant based on the nature and circumstances of the engagement, for example, an industry-specific methodology or related guides and performance aids.

#### ***Sufficient and Appropriate Resources to Perform the Engagement (Ref: par. 25)***

**A70.** In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, ordinarily, the engagement partner may depend on the firm's related policies or procedures (including resources) as described in paragraph A6. For example, based on information communicated by the firm, the engagement partner may be able to depend on the firm's technological development, implementation, and maintenance programs when using firm-approved technology to perform audit procedures.

**A70A.** The engagement partner may find it necessary to seek input from others with responsibilities for direction, supervision, and review to make the determinations required by paragraphs 25-27 of this proposed SAS.

Commented [A68]: From PwC letter

#### ***Competence and Capabilities of the Engagement Team (Ref: par. 26)***

**A71.** When determining that the engagement team has the appropriate competence and capabilities, the engagement partner may take into consideration such matters as the team's

- understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation.
- understanding of professional standards and applicable legal and regulatory requirements.
- expertise in specialized areas of accounting or auditing.
- expertise in IT used by the entity or automated tools or techniques that are to be used by the engagement team in planning and performing the audit engagement.
- knowledge of relevant industries in which the entity being audited operates.
- ability to exercise professional skepticism and professional judgment.
- understanding of the firm's policies or procedures.

**A72.** Internal auditors and an auditor's external specialist are not members of the engagement team. AU-C section 610<sup>31</sup> and AU-C section 620<sup>32</sup> include requirements and guidance relating to the assessment of the competence and capabilities of internal auditors and an auditor's external specialist, respectively.

***Project Management***

**A73.** In situations in which there are many engagement team members, for example, in an audit of a larger or more complex entity, the engagement partner may involve an individual who has specialized skills or knowledge in project management, supported by appropriate technological and intellectual resources of the firm. Conversely, in an audit of a less complex entity with few engagement team members, project management may be achieved by a member of the engagement team through less formal means.

**A74.** Project management techniques and tools may support the engagement team in managing the quality of the audit engagement by, for example

- increasing the engagement team's ability to exercise professional skepticism through alleviating budget or time constraints that may otherwise impede the exercise of professional skepticism;
- facilitating timely performance of audit work to effectively manage time constraints at the end of the audit process when more difficult or contentious matters may arise;
- monitoring the progress of the audit against the audit plan,<sup>33</sup> including the achievement of key milestones, which may assist the engagement team in being proactive in identifying the need for making timely adjustments to the audit plan and the assigned resources; or
- facilitating communication among members of the engagement team, for example, coordinating arrangements with component auditors and auditor's experts.

***Insufficient or Inappropriate Resources (Ref: par. 27)***

**A75.** Proposed SQMS *A Firm's System of Quality Management* addresses the firm's commitment to quality through its culture that exists throughout the firm, which recognizes and reinforces the firm's role in serving the public interest by consistently performing quality engagements, and the importance of quality in the firm's strategic decisions and actions, including the firm's financial and operational priorities. Proposed SQMS *A Firm's System of Quality Management* also addresses the firm's responsibilities for planning for resource needs and obtaining, allocating, or assigning resources in a manner that is consistent with the firm's commitment to quality. However, in certain circumstances, the firm's financial and operational priorities may place constraints on the resources assigned or made available to the engagement team. In such circumstances, these constraints do not override the engagement partner's responsibility for achieving quality at the engagement level, including for determining that the resources assigned or made available by the firm are sufficient and appropriate to perform the audit engagement.

**A76.** In an audit of group financial statements, when there are insufficient or inappropriate resources in relation to work being performed at a component by a component auditor, the engagement partner may discuss the matter with the component auditor, management, or the firm to make sufficient and appropriate resources available.

**A77.** The engagement partner's determination of whether additional engagement level resources are required is a matter of professional judgment and is influenced by the requirements of this proposed SAS and the nature and circumstances of the audit engagement. As described in paragraph A11, in certain circumstances, the engagement partner may determine that the firm's responses to quality risks are ineffective in the context of the specific engagement, including that certain resources assigned or made

<sup>31</sup> Paragraph .13 of AU-C section 610.

<sup>32</sup> Paragraph .09 of AU-C section 620.

<sup>33</sup> See paragraph .09 of AU-C section 300.

available to the engagement team are insufficient. In those circumstances, the engagement partner is required to take appropriate action, including communicating such information to the appropriate individuals in accordance with paragraph 27 and paragraph 39c. For example, if an audit software program provided by the firm has not incorporated new or revised audit procedures regarding recently issued industry regulation, timely communication of such information to the firm enables the firm to take steps to update and reissue the software promptly or to provide an alternative resource that enables the engagement team to comply with the new regulation in the performance of the audit engagement.

**A78.** If the resources assigned or made available are insufficient or inappropriate in the circumstances of the engagement and additional or alternative resources have not been made available, appropriate actions may include the following:

- Changing the planned approach to the nature, timing, and extent of direction, supervision, and review (see also paragraph A94)
- Discussing an extension to reporting deadlines with management or those charged with governance, when an extension is possible under applicable law or regulation
- Following the firm's policies or procedures for resolving differences of opinion if the engagement partner does not obtain the necessary resources for the audit engagement
- Following the firm's policies or procedures for withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation

***Considerations Specific to Audits of Governmental Entities (Ref: par. 25–28)***

**A79.** For audits of governmental entities, competence may include skills that are necessary to comply with applicable law or regulation, such as knowledge of *Government Auditing Standards* and an understanding of the applicable reporting requirements, including reporting to the legislature or other governing body or reporting in the public interest. The scope of a governmental audit may include, for example, additional requirements with respect to detecting misstatements that result from violations of provisions of contracts or grant agreements that could have a direct and material effect of the determination of financial statement amounts or the need to examine and report on internal control over financial reporting or compliance.

**Engagement Performance**

***Scalability (Ref: par. 29)***

**A80.** When an audit is not carried out entirely by the engagement partner, or in an audit of an entity whose nature and circumstances are more complex, it may be necessary for the engagement partner to assign direction, supervision, and review to other members of the engagement team. However, as part of the engagement partner's overall responsibility for managing and achieving quality on the audit engagement and to be sufficiently and appropriately involved, the engagement partner is required to determine that the nature, timing, and extent of direction, supervision, and review is undertaken in accordance with paragraph 30. In such circumstances, personnel or members of the engagement team, including component auditors, may provide information to the engagement partner to enable the engagement partner to make the determination required by paragraph 30.

***Direction, Supervision, and Review (Ref: par. 30)***

**A81.** Under proposed SQMS A *Firm's System of Quality Management*, the firm is required to establish a quality objective that addresses the nature, timing, and extent of the direction and supervision of engagement teams and review of their work. Proposed SQMS A *Firm's System of Quality Management* also requires that such direction, supervision, and review is planned and performed on the basis that the work performed by less experienced members of the engagement team is directed, supervised, and reviewed by more experienced engagement team members.

**A82.** Direction and supervision of the engagement team and the review of the work of the engagement team are firm-level responses that are implemented at the engagement level, of which the nature, timing, and extent may be further tailored by the engagement partner in managing the quality of the audit engagement. Accordingly, the approach to direction, supervision, and review will vary from one engagement to the next, taking into account the nature and circumstances of the engagement. The approach will generally include a combination of addressing the firm's policies or procedures and engagement-specific responses.

**A83.** The approach to the direction and supervision of the members of the engagement team and the review of their work provides support for the engagement partner in fulfilling the requirements of this proposed SAS and in concluding that the engagement partner has been sufficiently and appropriately involved throughout the audit engagement in accordance with paragraph 40.

**A84.** Ongoing discussion and communication among members of the engagement team allows less experienced engagement team members to raise questions with more experienced engagement team members (including the engagement partner) in a timely manner and enables effective direction, supervision, and review in accordance with paragraph 30.

#### *Direction*

**A85.** Direction of the engagement team may involve informing the members of the engagement team of their responsibilities, such as the following:

- Contributing to the management and achievement of quality at the engagement level through their personal conduct, communication, and actions
- Maintaining a questioning mind and being aware of unconscious or conscious auditor biases in ~~exercising~~ maintaining professional skepticism when gathering and evaluating audit evidence (see paragraph A354)
- Fulfilling relevant ethical requirements
- The responsibilities of respective partners when more than one partner is involved in the conduct of an audit engagement
- The responsibilities of respective engagement team members to perform audit procedures and of more experienced engagement team members to direct, supervise, and review the work of less experienced engagement team members
- Understanding the objectives of the work to be performed and the detailed instructions regarding the nature, timing, and extent of planned audit procedures as set forth in the overall audit strategy and audit plan
- Addressing threats to the achievement of quality, and the engagement team's expected response, for example, the threat that budget constraints or resource constraints result in the engagement team members inappropriately modifying planned audit procedures or failing to perform planned audit procedures

Commented [AG9]: To correct

#### *Supervision*

**A86.** Supervision may include matters such as the following:

- Tracking the progress of the audit engagement, which includes monitoring
  - the progress against the audit plan;
  - whether the objective of work performed has been achieved; and

- the ongoing adequacy of assigned resources
- Taking appropriate action to address issues arising during the engagement, including, for example, reassigning planned audit procedures to more experienced engagement team members when issues are more complex than initially anticipated
- Identifying matters for consultation or consideration by more experienced engagement team members during the audit engagement
- Providing coaching and on-the-job training to help engagement team members develop skills or competencies
- Creating an environment where engagement team members raise concerns without fear of reprisals

*Review*

**A87.** Review of the engagement team's work provides support for the conclusion that the requirements of this proposed SAS have been addressed.

**A88.** Review of the engagement team's work consists of consideration of whether, for example

- the work has been performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements;
- significant matters have been raised for further consideration;
- appropriate consultations have taken place, and the resulting conclusions have been documented and implemented;
- there is a need to revise the nature, timing, and extent of work performed;
- the work performed supports the conclusions reached and is appropriately documented;
- the evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion; and
- the objectives of the audit procedures have been achieved.

**A89.** The firm's policies or procedures may contain specific requirements regarding

- the nature, timing, and extent of review of audit documentation;
- different types of review that may be appropriate in different situations (for example, review of each individual working paper or selected working papers); and
- which members of the engagement team are required to perform the different types of review.

***The Engagement Partner's Review (Ref: par. 30–34)***

**A90.** As required by AU-C section 300, the engagement partner reviews the overall audit strategy and audit plan.<sup>34</sup> As required by AU-C section 230, the engagement partner documents the date and extent of the review.<sup>35</sup>

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<sup>34</sup> Paragraph .11 of AU-C section 300, as amended by this proposed SAS.

<sup>35</sup> Paragraph .09c of AU-C section 230.

**A91.** Timely review of documentation by the engagement partner at appropriate stages throughout the audit engagement enables significant matters to be resolved to the engagement partner's satisfaction on or before the date of the auditor's report. The engagement partner need not review all audit documentation. The engagement partner exercises professional judgment in determining the extent of documentation to be reviewed, for example, when determining the nature and extent of the review of component auditor documentation in a group audit.

**A92.** The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm's policies or procedures may specify certain matters that are commonly expected to be significant judgments. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. Examples follow:

- Matters related to planning the engagement, such as matters related to determining materiality
  - The composition of the engagement team, including
    - personnel using expertise in a specialized area of accounting or auditing
    - the use of personnel from service delivery centers
  - The decision to involve an auditor's specialist, including the decision to involve an external specialist
- The engagement team's consideration of information obtained in the acceptance and continuance process and proposed responses to that information
- The engagement team's risk assessment process, including situations in which consideration of inherent risk factors and the assessment of inherent risk requires significant judgment by the engagement team
- The engagement team's consideration of related party relationships and transactions and disclosures
- Results of the procedures performed by the engagement team on significant areas of the engagement, for example, conclusions concerning certain accounting estimates, accounting policies, or going concern considerations
- The engagement team's evaluation of the work performed by specialists and conclusions drawn therefrom
- In group audit situations
  - the proposed overall group audit strategy and group audit plan;
  - decisions about the involvement of component auditors, including how to direct and supervise them and review their work, including, for example, when there are areas of higher assessed risk of material misstatement of the financial information of a component; and
  - the evaluation of work performed by component auditors and the conclusions drawn therefrom
- How matters affecting the overall audit strategy and audit plan have been addressed

- The significance and disposition of corrected and uncorrected misstatements identified during the engagement
- The proposed audit opinion and matters to be communicated in the auditor's report, for example, key audit matters, or a "Material Uncertainty Related to Going Concern" paragraph.

**A93.** The engagement partner exercises professional judgment in determining other matters to review, for example, based on

- the nature and circumstances of the audit engagement.
- which engagement team member performed the work.
- matters relating to recent inspection findings.
- the requirements of the firm's policies or procedures.

*Nature, Timing, and Extent*

**A94.** The nature, timing, and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm's policies or procedures, as well as professional standards and applicable legal and regulatory requirements. For example, the firm's policies or procedures may include the following:

- Work planned to be performed at an interim date is to be directed, supervised, and reviewed at the same time as the performance of the procedures, rather than at the end of the period, so that any necessary corrective action can be taken in a timely manner.
- Certain matters are to be reviewed by the engagement partner, and the firm may specify the circumstances or engagements in which such matters are expected to be reviewed.

*Scalability*

**A95.** The following are examples of factors that may influence the firm's approach to direction, supervision, and review:

- The engagement team member's previous experience with the entity and the area to be audited. For example, if the work related to the entity's information system is being performed by the same engagement team member who performed the work in the prior period and there are no significant changes to the information system, the extent and frequency of the direction and supervision of the engagement team member may be less, and the review of the related working papers may be less detailed.
- The complexity of the audit engagement. For example, if significant events have occurred that make the audit engagement more complex, the extent and frequency of the direction and supervision of the engagement team member may be greater, and the review of the related working papers may be more detailed.
- The assessed risks of material misstatement. For example, a higher assessed risk of material misstatement may require a corresponding increase in the extent and frequency of the direction and supervision of engagement team members and a more detailed review of their work.

- The competence and capabilities of the individual engagement team members performing the audit work. For example, less experienced engagement team members may require more detailed instructions and more frequent, or in-person, interactions as the work is performed.
- The manner in which the reviews of the work performed are expected to take place. For example, in some circumstances, remote reviews may not be effective in providing the necessary direction and may need to be supplemented by in-person interactions.
- The structure of the engagement team and the location of engagement team members. For example, direction and supervision of individuals located at service delivery centers and the review of their work may
  - be more formalized and structured than when members of the engagement team are all situated in the same location, or
  - use IT to facilitate the communication between the members of the engagement team.

**A96.** Identification of changes in the engagement circumstances may warrant reevaluation of the planned approach to the nature, timing, or extent of direction, supervision, or review. For example, if the assessed risk of material misstatement at the financial statement level increases because of a complex transaction, the engagement partner may need to change the planned level of review of the work related to the transaction.

**A97.** In accordance with paragraph 30b, the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. For example, if a more experienced engagement team member becomes unavailable to participate in the supervision and review of the engagement team, the engagement partner may need to increase the extent of supervision and review of the less experienced engagement team members.

***Review of Communications to Management, Those Charged With Governance, or Regulatory Authorities (Ref: par. 34)***

**A98.** The engagement partner uses professional judgment in determining which written communications to review, taking into account the nature and circumstances of the audit engagement. For example, it may not be necessary for the engagement partner to review communications between the engagement team and management in the ordinary course of the audit.

***Consultation (Ref: par. 35)***

**A99.** Proposed SQMS A *Firm's System of Quality Management* requires the firm to establish a quality objective that addresses consultation on difficult or contentious matters and how the conclusions agreed are implemented. Consultation may be appropriate or required, for example, for

- issues that are complex or unfamiliar (for example, issues related to an accounting estimate with a high degree of estimation uncertainty);
- significant risks, ~~such as those that required significant auditor attention;~~
- significant transactions that are outside the normal course of business for the entity or that otherwise appear to be unusual;
- limitations imposed by management; and
- noncompliance with laws or regulations.

**Commented [AG10]:** This is no longer the definition of significant risk, with the issuance of SAS 142 and 145.

**A100.** Effective consultation on significant technical, ethical, and other matters within the firm or, where applicable, outside the firm, may be achieved when those consulted

- are given all the relevant facts that will enable them to provide informed advice and
- have appropriate knowledge, seniority, and experience.

**A101.** It may be appropriate for the engagement team, in the context of the firm's policies or procedures, to consult outside the firm, for example, in areas where the firm lacks appropriate internal resources. The engagement team may take advantage of advisory services provided by firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services.

**A102.** The need for consultation outside the engagement team on a difficult or contentious matter may be an indicator that the matter is a key audit matter.<sup>36</sup>

**Engagement Quality Review (Ref: par. 36)**

**A103.** Proposed SQMS *A Firm's System of Quality Management* contains requirements that the firm establish policies or procedures addressing engagement quality reviews in accordance with proposed SQMS *Engagement Quality Reviews*<sup>37</sup> and requiring an engagement quality review for certain types of engagements.<sup>38</sup> Proposed SQMS *Engagement Quality Reviews* deals with the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review.

*Completion of the Engagement Quality Review Before Dating of the Auditor's Report (Ref: par. 36d)*

**A104.** AU-C section 700 requires the auditor's report to be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements.<sup>39</sup> If applicable to the audit engagement, proposed SQMS *Engagement Quality Reviews* and this proposed SAS require that the engagement partner be precluded from ~~dating-releasing~~ the engagement report until notification has been received from the engagement quality reviewer that the engagement quality review is complete. For example, if the engagement quality reviewer has communicated to the engagement partner concerns about the significant judgments made by the engagement team or that the conclusions reached thereon were not appropriate, then the engagement quality review is not complete.<sup>40</sup>

**A105.** An engagement quality review that is conducted in a timely manner at appropriate stages during the audit engagement may assist the engagement team in promptly resolving matters raised to the engagement quality reviewer's satisfaction on or before the date of the auditor's report.

**A106.** Frequent communications between the engagement team and the engagement quality reviewer throughout the audit engagement may assist in facilitating an effective and timely engagement quality review. In addition to discussing significant matters with the engagement quality reviewer, the engagement partner may assign responsibility for coordinating requests from the engagement quality reviewer to another member of the engagement team.

*Differences of Opinion (Ref: par. 37–38)*

**A107.** Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish a quality objective that addresses differences of opinion that arise within the engagement team or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's system of quality management. Proposed SQMS *A Firm's System of Quality Management* also requires

<sup>36</sup> Paragraphs .09 and .A13b of AU-C section 701.

<sup>37</sup> Proposed SQMS *Engagement Quality Reviews*.

<sup>38</sup> Paragraph 35f of proposed SQMS *A Firm's System of Quality Management*.

<sup>39</sup> Paragraph .43 of AU-C section 700.

<sup>40</sup> Paragraph 21b of proposed SQMS *Engagement Quality Review*.

that differences of opinion are brought to the attention of the firm and resolved. For example, a component auditor may be instructed to communicate differences of opinion to the group engagement team.

**A108.** In some circumstances, the engagement partner may not be satisfied with the resolution of the difference of opinion. In such circumstances, appropriate actions for the engagement partner may include, for example

- seeking legal advice or
- withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

**Monitoring and Remediation (Ref: par. 39)**

**A109.** Proposed SQMS *A Firm's System of Quality Management* sets out requirements for the firm's monitoring and remediation process. Proposed SQMS *A Firm's System of Quality Management* requires the firm to communicate to engagement teams information about the firm's monitoring and remediation process to enable them to take prompt and appropriate action in accordance with their responsibilities. Further, information provided by members of the engagement team may be used by the firm in the firm's monitoring and remediation process, and exercising professional judgment and maintaining professional skepticism while conducting the audit may assist the members of the engagement team in remaining alert for information that may be relevant to that process.

**A110.** Information provided by the firm may be relevant to the audit engagement when, for example, it relates to findings on another engagement performed by the engagement partner or other members of the engagement team, findings from the local firm office, or inspection results of previous audits of the entity.

**A111.** In considering information communicated by the firm through its monitoring and remediation process and how it may affect the audit engagement, the engagement partner may consider the remedial actions designed and implemented by the firm to address deficiencies and, to the extent relevant to the nature and circumstances of the engagement, communicate accordingly to the engagement team. The engagement partner may also determine whether additional remedial actions are needed at the engagement level. For example, the engagement partner may determine that

- an auditor's specialist is needed, or
- the nature, timing, and extent of direction, supervision, and review needs to be enhanced in an area of the audit where deficiencies have been identified.

If an identified deficiency does not affect the quality of the audit (for example, if it relates to a technological resource that the engagement team did not use), then no further action may be needed.

**A112.** A deficiency in the firm's system of quality management does not necessarily indicate that an audit engagement was not performed in accordance with professional standards and applicable legal and regulatory requirements or that the auditor's report was not appropriate in the circumstances.

**Taking Overall Responsibility for Managing and Achieving Quality (Ref: par. 40)**

**A113.** Proposed SQMS *A Firm's System of Quality Management* requires the firm to establish a quality objective addressing the engagement team's understanding and fulfillment of their responsibilities in connection with the engagement. Proposed SQMS *A Firm's System of Quality Management* further requires that the quality objective include the overall responsibility of engagement partners for managing and

achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.

**A114.** Relevant considerations in addressing paragraph 40 include determining how the engagement partner has complied with the requirements of this proposed SAS, given the nature and circumstances of the audit engagement and how the audit documentation evidences the engagement partner's involvement throughout the audit engagement, as described in paragraph A118.

**A115.** Indicators that the engagement partner may not have been sufficiently and appropriately involved include, for example, the following:

- Lack of timely review by the engagement partner of the audit engagement planning, including reviewing the assessment of risks of material misstatement and the design of those responses to those risks towards the end of the audit
- Evidence that assignees were not provided necessary instructions and relevant information, such as not being adequately informed about the nature of their responsibilities and authority, the scope of the work being assigned and the objectives thereof
- A lack of evidence of the engagement partner's direction and supervision of the other members of the engagement team and the review of their work

**A116.** If the engagement partner's involvement does not provide the basis for determining that the significant judgments made and the conclusions reached are appropriate, the engagement partner will not be able to reach the determination required by paragraph 40. In addition to ~~considering applying~~ firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example

- updating and changing the audit plan;
- reevaluating the planned approach to the nature and extent of review and modifying the planned approach to increase the involvement of the engagement partner; or
- consulting with personnel assigned operational responsibility for the relevant aspect of the firm's system of quality management.

Commented [AG11]: Change back OPEN

#### **Documentation (Ref: par. 41)**

**A117.** In accordance with AU-C section 230,<sup>41</sup> audit documentation provides evidence that the audit complies with GAAS. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file.

**A118.** Documentation of the performance of the requirements of this proposed SAS, including evidencing the involvement of the engagement partner and the engagement partner's determination in accordance with paragraph 40, may be accomplished in different ways depending on the nature and circumstances of the audit engagement. Examples follow:

- Direction of the engagement team can be documented through sign-offs of the audit plan and project management activities.

<sup>41</sup> Paragraph .A9 of AU-C section 230.

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- Minutes from formal meetings of the engagement team may provide evidence of the clarity, consistency, and effectiveness of the engagement partner's communications and other actions regarding culture and expected behaviors that demonstrate the firm's commitment to quality.
- Agendas from discussions between the engagement partner and other members of the engagement team and, when applicable, the engagement quality reviewer, and related sign-offs and records of the time the engagement partner spent on the engagement, may provide evidence of the engagement partner's involvement throughout the audit engagement and supervision of other members of the engagement team.
- Sign-offs by the engagement partner and other members of the engagement team provide evidence that the working papers were reviewed.

**A119.** When dealing with circumstances that may pose risks to achieving quality on the audit engagement, the exercise of professional skepticism, and the documentation of the auditor's consideration thereof, may be important. For example, if the engagement partner obtains information that may have caused the firm to decline the engagement (see paragraph 24), the documentation may include explanations of how the engagement team dealt with the circumstance.

**A120.** Documentation of consultations with other professionals that involve difficult or contentious matters that is sufficiently complete and detailed contributes to an understanding of

- the nature and scope of the issue on which consultation was sought, and
- the results of the consultation, including any decisions taken, the basis for those decisions, and how they were implemented.

### Detailed Comments – QM SAS

Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
1	74	QM SAS Overall	The Tennessee Comptroller of the Treasury, Department of Audit, primarily follows quality management standards promulgated by the GAO in Government Auditing Standards. Thus, the proposed changes will not greatly affect our government audit organization. We agree the proposed changes are reasonable, and the language is clear, understandable, and helpful. The application material provided is also sufficient to explain how to apply the requirements in practice.	Noted
2	83	QM SAS Overall	We believe the requirements are clear and understandable and that the application material is helpful in supporting the application of the requirements. Specific guidance, via examples or hypothetical questions with answers, would be beneficial for implementing the standard.	Noted
3	90	QM SAS Overall	We agree with the proposed changes to the existing standard, believe the requirements are clear and understandable, and determine that the application material is helpful.	Noted
4	110	QM SAS Overall	We are generally supportive of the changes proposed in the QM SAS. However, due to the stand-back requirement being new, we request the Board provides greater clarification and develop practice aids to assist the engagement partner and firm in adhering to the stand back requirement.	Noted
5	116	QM SAS Overall	We acknowledge agreement and support of the QM SAS.	Noted
6	121	QM SAS Overall	4a. We strongly support the proposed QM SAS. We agree that the engagement partner needs to be sufficiently and appropriately involved throughout the engagement to achieve high quality audits and agree with the proposed requirements.	Noted
7	123	QM SAS Overall	We generally agree with the ED and with the proposed effective date. As a state audit organization, our comments are limited to the proposed statement on auditing standard	Noted

<sup>1</sup> List of CL respondents was provided as agenda item 4A in the materials for the October ASB meeting (<https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/asb/downloadabledocuments/202110-asb-item4a.pdf>)

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			and do not extend to the proposed statements on quality management standards, which do not apply to government audit organizations. Our comments on the ED are as follows:	
8	124	QM SAS Overall	To the extent the requirements mirror the quality control standards mentioned above, the committee has the same concerns with the application of the SAS.	Noted
9	128	QM SAS Overall	We support the proposed QM SAS and believe the proposed requirements are clear and understandable. We further believe that the application material supports the requirements and makes clear that the engagement partner has overall responsibility for managing and achieving quality and is ultimately accountable for compliance with the requirements of the proposed QM SAS.	Noted
10	130	QM SAS Overall	We believe the requirements are generally understandable	
11	134	QM SAS Overall	<p>Group audits</p> <p>We are concerned that the extent of the requirements and the resulting responsibilities that lay directly with the engagement partner could make this standard too onerous to apply to large single-entity engagements or large multinational engagements. We would recommend that the application of the requirements in these circumstances be considered as part of the QM SAS. While we appreciate that, from a group audit perspective, the IAASB and ASB have indicated that the responsibilities of the group engagement partner will be considered in their respective projects on group audits, there will probably be a period of time when QM SAS is effective, but the revisions to AU-C section 600 will still be in development. We are concerned that this would be detrimental to audit quality. As a result, if these requirements are to remain in a revised standard, we recommend that the ASB provide guidance on how to apply these requirements to large single-entity engagements or multinational engagements when the revised standard is approved. If these requirements are not considered as part of the QM SAS, we would recommend that the effective dates of the QM SAS and a revised AU-C section 600 be aligned.</p>	Consider aligning effective dates of Group Audit SAS with QM SAS. Note that if ASB agrees with delaying QM standards to 12/15/25, Group Audit SAS unlikely to be later.
12	145	QM SAS Overall	For our membership, our typical engagement team consists of 2 to 5 team members (including the engagement partner). The partners are significantly involved in all phases of an engagement from planning (including the selection of and intimately knowledge of the engagement staff) to engagement wrap-up. We are of the opinion that this already gives us an advantage because the engagement partner, as team leader, fulfills his or her leadership responsibilities. This includes taking actions to create an environment for the engagement that emphasizes the firm’s culture and the expected behavior of engagement team members; assigning procedures, tasks, or actions to other members of the engagement team; and supporting engagement performance,	Noted

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			including taking responsibility for the nature, timing, and extent of the direction, supervision, and review of the work performed. However, for those firms that would be affected by this proposed SQMS, the requirements in proposed QM SAS are clear and understandable, and the application materials would be helpful. Additionally, we are of the opinion the proposed changes would not be scalable for our membership because the added cost and burden of implementation and maintenance would result in placing our firms at a competitive disadvantage.	
13	06	QM SAS Overall\1 Strongly support	We strongly support the majority of the new SQMS	Noted
14	40	QM SAS Overall\1 Strongly support	We support the ASB’s efforts to clarify and strengthen the key elements of quality management and the related specific responsibilities of the engagement partner and auditor at the engagement level for an audit of financial statements. In general, we believe that the requirements in the proposed QM SAS are clear and understandable and that the application material is helpful.	Noted
15	55	QM SAS Overall\1 Strongly support	The Committee members agreed that the requirements in the proposed QM SAS are clear and understandable. This exposure draft has made explicit what was inherently assumed, and hence makes it easier to understand and implement. The application material is useful and has sufficient examples to illustrate the requirements.	Noted
16	61	QM SAS Overall\1 Strongly support	CRI supports the changes outlined in proposed QM SAS. The proposed QM SAS has clarified the role and responsibilities of the engagement partner from the existing guidance in AU-C Section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards. The application material is helpful in supporting the application of those responsibilities.	Noted
17	65	QM SAS Overall\1 Strongly support	X I strongly support the proposed QM SAS	Noted
18	77	QM SAS Overall\1 Strongly support	We agree with the proposed QM SAS which clarifies the engagement partner’s overall responsibility for managing and achieving audit quality which includes creating an environment that emphasizes the firm’s culture and expected behavior of engagement team members. This extends to the engagement partner’s involvement throughout the engagement which is inclusive of the engagement partner’s leadership responsibility, stand back responsibility, and the direction, supervision and review of the engagement team.	Noted

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
19	93	QM SAS Overall\1 Strongly support	We agree with the language in the proposed auditing standard that requires the engagement partner to take ultimate responsibility for ensuring the overall quality of the engagement.	Noted
20	135	QM SAS Overall\1 Strongly support	We acknowledge agreement and support of the QM SAS.	Noted
21	138	QM SAS Overall\1 Strongly support	We strongly support the proposed QM SAS	Noted
22	144	QM SAS Overall\1 Strongly support	I strongly support the proposed QM SAS.	Noted
23	158	QM SAS Overall\1 Strongly support	We strongly support the proposed QM SAS and its requirements are clear and understandable. The application material in the proposed QM SAS is helpful in supporting the requirements.	Noted
24	159	QM SAS Overall\1 Strongly support	strongly support the proposed QM SAS	Noted
25	162	QM SAS Overall\1 Strongly support	I strongly support the proposed QM SAS	Noted
26	163	QM SAS Overall\1 Strongly support	We agree with the language in the proposed auditing standard that requires the engagement partner to take ultimate responsibility for ensuring the overall quality of the engagement.	Noted
27	167	QM SAS Overall\1 Strongly support	We agree with the requirements outlined in this standard regarding engagement partner responsibilities.	Noted
28	47	QM SAS Overall\2 Somewhat support	We understand that requirements in the proposed QM SAS represent a shift from a more standardize quality control approach to a risk-assessment approach at the firm level, which will require significant effort to implement. In concept, we agree that risk-assessment approach is in the public interest. In practice, many firms rely on templated resources to help consider and document quality management, therefore, the shift to a more “free form,” risk-based approach will likely be a heavy burden. NASBA suggests robust implementation guidance be available to help guide firms through the process.	Noted
29	100	QM SAS Overall\2 Somewhat support	As noted throughout this letter, TIC strongly supports the enhancement of quality throughout all types of engagements; however, we have concerns with some aspects of the QM SAS, but somewhat support the proposed SAS.	Noted
30	147	QM SAS Overall\2 Somewhat support	Overall, we support the proposed QM SAS and believe the requirements are generally clear and understandable, effectively addressing the engagement partner’s ultimate responsibility for ensuring the overall quality of the engagement. The proposed QM SAS appears consistent with and logically linked to the proposed SQMS standards.	To be clarified thru Group Audits project

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			<p>However, the Committee does request clarification regarding the extent of the engagement partner’s responsibility in relation to members of a component auditor’s engagement team outside of the partner’s own firm.</p> <p>The QM SAS application material, specifically paragraphs A23 - 24, discuss considerations of the engagement partner in relation to members of an engagement team outside of the partner’s firm.</p>	
31	156	QM SAS Overall\2 Somewhat support	I support the proposed QM SAS	Noted
32	164	QM SAS Overall\2 Somewhat support	We somewhat support the proposed QM SAS.	Noted
33	168	QM SAS Overall\2 Somewhat support	I somewhat support the proposed QM	Noted
34	76	QM SAS Overall\3 Somewhat oppose	I somewhat oppose the proposed QM SAS	Noted
35	130	QM SAS Overall\3 Somewhat oppose	We somewhat oppose the proposed QM SAS	Noted
36	146	QM SAS Overall\3 Somewhat oppose	We somewhat oppose the proposed QM SAS as it applies to smaller firms as discussed above.	Noted
37	161	QM SAS Overall\3 Somewhat oppose	<p>We support the intent of the revisions, which is to promote consideration of risks to quality at the engagement level, and support many of the proposed revisions. We agree that the engagement partner needs to be sufficiently and appropriately involved throughout the audit to be able to take overall responsibility for the quality of the engagement.</p> <p>However, in building a framework that best supports audit quality, it is important that the requirements in the QM SAS are grounded in a risk-based approach, and are sufficiently principles-based so that they can be appropriately applied across a variety of engagement team structures in a scalable manner, commensurate with the size and complexity of the entity being audited. We are concerned that the proposed SAS is not capable of being effectively implemented in light of the variety of audit delivery models that exist today and how such models (and the technology that supports them) are likely to evolve in the future.</p>	<p>Concern that QM SAS is too prescriptive and words “determine” and “review”.</p> <p>TF addressed this when developing the exposure draft, and believes that clarification of paragraphs 9 and A10 is most appropriately addressed thru implementation and application guidance.</p>

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			<p>New audit delivery models, through which quality is often reinforced through quality control procedures embedded in their design, are typically governed by a firm’s System of Quality Management (SoQM); engagement partners should be able to rely on these firm-level controls to support the execution of quality audits. It is important that the SAS reflect the changing nature of audits and not introduce prescriptive requirements that may impede, rather than support, audit quality. In revising AU-C section 220, the ASB should establish principles-based requirements that promote appropriate review and supervision, and develop accompanying material to support the application of those requirements in various circumstances.</p> <p>We support the assignment of responsibility to others to assist the engagement partner in fulfilling their quality responsibilities. In principle, we believe that the engagement partner should assign responsibility for aspects of quality to those most qualified to deliver on it. In our view, the engagement partner can retain overall responsibility for the engagement while delegating elements of execution that support that responsibility. It is also important to acknowledge that the firm’s policies and procedures are applied to specific engagements or structures based on their assessed risks; not all engagements have the same risks and therefore different responses may be appropriate in order to achieve the same quality objective.</p> <p>In our view, the proposed SAS needs to be revised to better reflect the principle of shared accountability for aspects of quality, and what would practically be achievable by the engagement partner. Although the application material provides examples of how the requirements can be applied in certain situations, we are concerned with the overall shift in the proposed QM SAS from the context in extant AU-C section 220 of the engagement partner being satisfied regarding certain matters to more robust requirements for the engagement partner to “determine” and “review” a broader range of matters. In these cases, we do not believe the application material can be used to overcome the prescriptive nature of the revised requirements. Particularly as it relates to large and complex engagements, it may not be feasible for the engagement partner to “determine” or “review” in accordance with all of the requirements outlined in the proposed QM SAS, as further discussed in our response to Question 4. Imposing these requirements on the engagement partner, rather than permitting such conclusions to be drawn by other suitability qualified members of the engagement team, may otherwise serve to detract from audit quality.</p>	

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			Paragraph A10 of the proposed SAS acknowledges that ordinarily the engagement team may depend on the firm’s policies and procedures to comply with the requirements of the proposed SAS. Paragraph 9 notes that the engagement partner may need to obtain information from the firm or other members of the engagement team to be able to fulfill particular responsibilities set forth in the proposed SAS. We believe these concepts should be made more prominent in the proposed SAS, and potentially implementation guidance, to assist auditors in understanding how the proposed SAS can be applied to various structures that have become more common. In particular, we are concerned with how the requirements of the proposed SAS interact with AU-C section 600, and believe the ASB needs to consider this before finalizing the proposed SAS to ensure it can be practically applied.	
38	99	QM SAS Overall\4 Strongly oppose	I strongly oppose the proposed QM SAS	Noted
39	65	QM SAS Overall\Specific comments	My former firm has extensive policies and procedures in place for addressing the management of quality at the engagement level, emphasizing the importance of the exercise of professional skepticism, enhancing the documentation of the auditor’s judgments, and robust communications during the engagement.	Noted
40	75	QM SAS Overall\Specific comments	If the engagement partner does not have the appropriate expertise, experience and level of involvement in the conduct of the engagement, it is highly unlikely that a quality engagement will be performed. Therefore, we strongly support the provisions of the ED related to the engagement partner’s responsibility for managing quality, including the “stand-back” requirement.	Noted
41	76	QM SAS Overall\Specific comments	I do not think this is an big issue in small firms as audit partners are already more involved throughout the entire audit process. Seems more of a large firm issue.	Noted
42	95	QM SAS Overall\Specific comments	The committees think that the preceding changes, with exception of those noted in previous comments, are beneficial to the goal of continued audit quality. The requirements are clear and understandable, and the application materials are somewhat helpful.	Noted
43	98	QM SAS Overall\Specific comments	We agree with the language in the proposed auditing standard that requires the engagement partner to take ultimate responsibility for ensuring the overall quality of the engagement.	Noted

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
44	103	QM SAS Overall\Specific comments	Overall, the application material is helpful in supporting the application of the proposed QM SAS.	Noted
45	109	QM SAS Overall\Specific comments	<p>Engagement Partner's Overall Responsibility for Managing Quality on Audits, Including Engagement Performance and Stand Back</p> <p>The Committee agrees with the proposed changes in an engagement partner's overall responsibility for managing quality on audits. The timely review of documentation at appropriate stages, as discussed in Par. 30-31 and A91, provides excellent guidance on ensuring that review of documentation should occur throughout the engagement rather than at the end to better facilitate the report date being as close to the end of fieldwork as possible. Adding the Stand Back requirement Par. 40, properly adds emphasis to the engagement partner taking responsibility for an audit engagement. The Stand Bank requirement will help prevent the engagement partner from passing this responsibility to a manager or director unless it is documented that the partner has passed the engagement partner responsibility to someone who has the experience and knowledge to perform this responsibility.</p> <p>Engagement Resources</p> <p>The Committee has the most concern about maintaining the necessary human and intellectual resources for engagements performed by smaller firms. The public accounting industry is dealing with more and more areas requiring the use of resources while the pool of human and intellectual resources has been reducing. This lack of responsibility could cause difficulty finding and training enough CPAs to fulfill the requirements of the new standards.</p> <p>Other New Requirements</p> <p>The Committee feels the clarification added on what the engagement partner needs to review will help focus engagement partners on the things that matter at that level of review. With the reduced availability of staff, the engagement partner needs to be as efficient as possible in reviewing the most valuable sections of the audit versus looking over every workpaper.</p> <p>The Committee feels the requirements in the proposed QM SAS are clear and understandable. The application material is helpful; however, we believe significant implementation guidance will need to be provided, especially to smaller firms.</p>	Noted

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
46	130	QM SAS Overall\Specific comments	We believe the requirements are generally understandable, however, we believe more information is necessary to fully appreciate the new stand back requirement and the engagement resources requirement.	Add to implementation guidance
47	134	QM SAS Overall\3 Somewhat oppose	We agree that to take overall responsibility for managing and achieving quality on the audit engagement, the involvement of the engagement partner needs to be both sufficient and appropriate. However, there is a level of prescription to these proposed requirements that is not consistent with a principles-based approach. We further believe there are areas where additional clarity is necessary in order to make the QM SAS sufficiently operational, particularly for group audits.	To be addressed thru Group Audit project (including potential amendments to QM SAS).
48	134	QM SAS Overall\Specific comments	Group audits We are concerned that the extent of the requirements and the resulting responsibilities that lay directly with the engagement partner could make this standard too onerous to apply to large single-entity engagements or large multinational engagements. We would recommend that the application of the requirements in these circumstances be considered as part of the QM SAS. While we appreciate that, from a group audit perspective, the IAASB and ASB have indicated that the responsibilities of the group engagement partner will be considered in their respective projects on group audits, there will probably be a period of time when QM SAS is effective, but the revisions to AU-C section 600 will still be in development. We are concerned that this would be detrimental to audit quality. As a result, if these requirements are to remain in a revised standard, we recommend that the ASB provide guidance on how to apply these requirements to large single-entity engagements or multinational engagements when the revised standard is approved. If these requirements are not considered as part of the QM SAS, we would recommend that the effective dates of the QM SAS and a revised AU-C section 600 be aligned.	To be addressed thru Group Audit project (including potential amendments to QM SAS).
49	139	QM SAS Overall\Specific comments	We have the same issues with the proposed Statement on Auditing Standards as it does with the proposed Statement on Quality Management.	Noted
50	150	QM SAS Overall\Specific comments	Our views on the QM SAS as we understand it is, we are for the overall concept of encouraging proactive management of quality at the engagement level, emphasizing the importance of the exercise of professional skepticism and the need for robust communication during the audit. We are not in favor of additional documentation requirements enhancing the documentation of auditor's judgements. The application material is helpful in supporting the application of the requirements.	Noted

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			In the small firm context, nothing has changed. The engagement partner already has those responsibilities and requiring more documentation does nothing to improve the quality of the audit. It may provide some protection for an inadequate attestation engagement, however, it really is just another cost incurred that makes it difficult for small firms performing attestation engagements. As stated previously, there is a real need for attestation engagements that regional and national firms have no interest in. However, the public interest in the smaller engagement arena is still and will always be relevant and the cost of providing those service keeps rising without a reasonable expectation that the entities in need can afford the services. It's not rocket science, there needs to be a vehicle for local firms to provide attestation services competitively without undue and unrealistic requirements.	
51	151	QM SAS Overall\Specific comments	For our firm, our typical engagement team consists of 2 to 5 team members (including the engagement partner). The partners are significantly involved in all phases of an engagement from planning (including the selection of and intimately knowledge of the engagement staff) to engagement wrap-up. We are of the opinion this gives us the advantage of having the engagement partner as team leader to fulfill their leadership responsibilities, including taking actions to create an environment for the engagement that emphasizes the firm's culture and the expected behavior of engagement team members, and assigning procedures, tasks, or actions to other members of the engagement team and supporting engagement performance, including taking responsibility for the nature, timing, and extent of the direction, supervision, and review of the work performed. However, for those firms that would be affected by this proposed SQMS, the requirements in proposed QM SAS are clear and understandable, and the application materials would be helpful.	Noted
52	155	QM SAS Overall\Specific comments	We believe that the preceding changes discussed and in the proposed QM SAS were clear and understandable. The application material is helpful and supports the application of the requirements.	Noted
53	162	QM SAS Overall\Specific comments	We support the development of the proposed quality management standards, including the QM SAS, and believe the proposed standards may serve the public interest.	Noted
54	65	QM SAS requirements	Yes	Noted
55	65	QM SAS requirements	The ED information is consistent with my former Firm's policies and procedures.	Noted

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
56	69	QM SAS requirements	We agree with the language in the proposed auditing standard that requires the engagement partner to take ultimate responsibility for ensuring the overall quality of the engagement.	Noted
57	100 TIC	QM SAS requirements	The requirements in the QM SAS are clear and understandable; however, TIC believes that they may be difficult for some firms to implement.	Noted
58	138	QM SAS requirements	Yes	Noted
59	146	QM SAS requirements	Yes, the materials are clear and understandable to us, but we have a concern that they will not be clear to smaller firms.	Noted
60	156	QM SAS requirements	Yes, based on our initial reading of QM SAS, although our review has not been extensive.	Noted
61	162	QM SAS requirements	Yes, we believe the requirements in the QM SAS are overall clear and understandable	Noted
62	164	QM SAS requirements	Yes, the requirements are clear and understandable. 4c. Yes, the application material is helpful.	Noted
63	161	QM SAS requirements\par. 8	Paragraph 8 of the proposed QM SAS acknowledges that, in an audit of an entity whose nature and circumstances are more complex, the engagement partner may assign the design or performance of some procedures, tasks, or actions to other members of the engagement team. In our view, paragraph 4 of PCAOB AS 1201, Supervision of the Audit Engagement, better articulates the concept of additional engagement team members who assist the engagement partner with supervision of the work of other engagement team members and promotes greater accountability by those to which such work is assigned or delegated. We note this concept was similarly articulated in paragraph 6 of extant AU-C section 220, which specifies that “The engagement partner may use the assistance of other members of the engagement team or other personnel within the firm in meeting the requirements of this section.” This terminology acknowledges that the engagement partner remains ultimately responsible for quality on the engagement, but also recognizes other suitably qualified members of the engagement team may perform a significant role with respect to direction, supervision, and review in order to achieve audit quality in the context of the specific engagement. We believe this concept should be explicitly retained in the ASB’s standards; moving away from it could result in a significant change in practice without a commensurate increase in audit quality and creates an unnecessary divergence from PCAOB standards.	See last three rows of this table.

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
64	40	QM SAS requirements\par. 12	<p>We suggest the following items to QM SAS Definitions in paragraph 12:                      Include the full definition of “network” as defined in the AICPA Code of Professional Conduct.                      Define the term “remediation.”                      Include and define “inspections.” There are several references to inspections in the application guidance. It is our view that inspections should be defined in the definition section to enhance the clarity and ability of the auditor to implement the standard.</p>	<ul style="list-style-type: none"> <li>• Revised consistent with QM1</li> <li>• No change, dictionary meaning.</li> <li>• Added, consistent with QM1</li> </ul>
65	134	QM SAS requirements\par. 13	<p>For example, we note that paragraph 13 of the QM SAS requires the engagement partner to determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement. There is little guidance on how the engagement partner evidences the basis for the conclusion reached. We would recommend the incorporation of additional guidance on the documentation expected to demonstrate compliance with this requirement.</p>	<p>See paragraph A30.</p>
66	77	QM SAS requirements	<p>We agree with the requirement in proposed QM SAS that an engagement partner is responsible for compliance with relevant ethical requirements.</p> <p>We agree with the requirements in proposed QM SAS that an engagement partner is responsible for resources used on an engagement, including technological, intellectual, and human resources. We would like the Board to provide guidance on the use of new technology within audits, specifically the engagement partner’s understanding of new technology as approved by the firm and other technical bodies. As with any technology, the engagement team or others within the firm may be more knowledgeable regarding certain systems or methods, for example data analysis processes and procedures, firm-wide industry data and other emerging audit techniques. In certain cases, the specific expertise may not rest with the engagement partner. In these cases, we recommend guidance for understanding the technology used in the audit and a method for the engagement partner to document the understanding and its use within the engagement.</p> <p>We agree with the specific items which require engagement partner review. We also recognize that significant matters and judgments will be different for each engagement. The formal written communications to management and those charged with governance are considered reasonable.</p>	<p>For implementation material; also see QM 1 re: technological resources</p>

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
67	89	QM SAS requirements\par. 14, 17, 35, 37	<p>Requirements and application material are generally clear, but we have concerns about the indication that “take responsibility for” means that the engagement partner is permitted to assign these responsibilities to another appropriately skilled or suitably experienced member of the engagement team. We believe that certain responsibilities that appear to be permitted to be “assigned” should not be. Examples of such provisions are noted below.</p> <p>Section 14: establishing and communicating the firm’s commitment to quality and the expected behavior of engagement team members</p> <p>Section 17: making engagement team members aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm’s related policies or procedures, including identifying, evaluating and addressing threats to compliance with independence</p> <p>Section 35: undertaking consultation on difficult or contentious matters and matters on which the firm’s policies and procedures require consultation</p> <p>Section 37: resolving differences of opinion in accordance with the firm’s policies or procedures</p> <p>We agree the engagement partner may need to leverage others in the firm to fulfill all of his/her responsibilities, but the standard should be very clear that the engagement partner has ultimate responsibility for seeing that all of these are carried out on their engagements.</p>	We believe this is consistent with the proposed standard. See par. 9 & 15.
68	65	QM SAS Requirements/Par. 31	Yes. The proposed QM SAS clarifies that the engagement partner needs to review-significant matters and significant judgments, and formal written communications to management and those charged with governance. The ASB should consider also requiring the engagement partner to review engagement planning on a timely basis (i.e., completed prior to the start of substantial audit work). Engagement quality is most effectively built into the engagement at its start, during planning, not at the end of the engagement.	Overly prescriptive.
69	76	QM SAS requirements\Par. 40	We do not feel the proposed "stand back" requirement is needed in a small firm setting. Audit partners are highly involved with the entire audit process in a small firm setting and therefore already have a high level of involvement. This would be an unnecessary additional requirement that is not needed.	For implementation material; related to documentation requirements.

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
70	86	QM SAS requirements\par. 40	This new requirement seems overly theoretical, and it is not clear how it differs from concluding on the engagement and adding a check mark on a checklist. If this requirement is retained, the committees request that the requirement be clarified.	Agree
71	97	QM SAS requirements\Par. 40	the stand back position insinuates that engagement partners are too involved in the engagement and therefore can't be impartial in evaluating the engagement. And that the engagement partners have been not living up to their responsibilities relative to the existing auditing standards and to the existing QC standards. Maybe the ASB should stop indicting the members of the profession and take the perception that perhaps most of the members do better than a decent job in performing audits and reviews and other attest type of engagements.	Disagree – the standback position addresses the risk that the engagement partner has not been sufficiently involved. See paragraph A115.
72	103	QM SAS requirements\Par. 40	Stand back” requirement – The requirement to assess the sufficiency and appropriateness of the partner’s involvement in an engagement has been inherent in the quality management system of a firm prior to the proposed QM SAS. We recommend expanding on this guidance to establish a framework by which partners and firms may make an assessment.	See AM A115
73	119	QM SAS requirements\Par. 40	This new requirement seems overly theoretical, and it is not clear how it differs from concluding on the engagement and adding a check mark on a checklist. If this requirement is retained, we request that the requirement be clarified.	The intent is for the engagement partner is required to self-reflect on the adequacy of his/her involvement on the audit.
74	121	QM SAS requirements\Par. 40	<p>4b. Yes, the requirements in the proposed QM SAS are clear and understandable. We would encourage the ASB to provide implementation and other nonauthoritative guidance, specifically as it relates to the “stand-back” requirement, including determining that the involvement of the engagement partner in the audit has been sufficient and appropriate throughout the engagement.</p> <p>The examples provided in the proposed QM SAS application material are clear but may have the unintended consequence of limiting the qualitative and quantitative methods/measures used or result in boilerplate responses. I</p> <p>Implementation and other nonauthoritative guidance could address the definition of timely review – is it by actual date of sign-off or number of hours invested in each phase of the audit? Such guidance may include an emphasis on the importance of a one size does not fit all, attributes of partner involvement should be risk-based and scalable to the nature and size of the audit engagement. Without further guidance, we believe there will be inconsistency in practice and audit quality will not be enhanced as intended.</p>	Noted for implementation guidance

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
75	155	QM SAS requirements\Par. 40	However, while we acknowledge the concept of the “stand-back” requirement reflected in paragraph .40, it is not clear to us how this evaluation is expected to be documented. In the absence of application material with such guidance, we expect this will evolve to be little more than one or more steps in an engagement checklist. If the Board has specific documentation expectations for this requirement, we recommend including additional related application material.	Noted for implementation guidance
76	166	QM SAS requirements\Par. 40	Is the “stand back” requirement in this section, the responsibility of the engagement partner, or is this fulfilled by another partner outside of the engagement? I read this to mean that the engagement partner is required to self-reflect on the adequacy of his/her involvement on the audit.	That is the intended meaning.
77	123	QM SAS requirements\Par. 40	<p>Regarding paragraph 40, we consider it confusing that the “engagement partner” is required to “...determine that the engagement partner has taken overall responsibility for managing and achieving quality on the audit engagement.” We are left wondering when such a self-determination would result in that not being the case. The subsequent bullet point in paragraph 40 directs the engagement partner to self-assess that their involvement has been “sufficient and appropriate”. We would not consider such a self-evaluation as prudent and wonder if the Board intended for someone other than the engagement partner to reach such conclusions.</p> <p>In addition, application paragraph A113 (providing additional guidance to paragraph 40) specifically mentions the application of the proposed statement on quality control management which will not be applicable to government audit organizations; therefore, we would appreciate additional explanation in this paragraph how it would apply to government audit organizations.</p>	<p>The intent is that the engagement partner is required to self-reflect on the adequacy of his/her involvement on the audit.</p> <ul style="list-style-type: none"> <li>• GAOs would have to apply the requirements in the QM SAS; the application of SQMS 1 is irrelevant.</li> </ul>
78	143	QM SAS requirements	<p>D&amp;T has recommended a number of changes to the proposed QM standards related to engagements conducted in accordance with GAS (refer Appendix 1, responses to question 1 - paragraph 5, and question 3 – paragraphs 2 and A48).</p> <p>In addition to considering the specific edits we are recommending in Appendix 1, we believe that the ASB should holistically revisit all requirement and guidance paragraphs in the proposed QM standards that address GAS in order to review that the appropriate terminology and references are consistently used. In addition, such requirements and</p>	Reviewed; TF believes all such references in QM SAS are appropriate.

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			terminology should align with the GAS 2018 Revision, inclusive of the Technical Update April 2021, as issued by the Comptroller General of the United States.	
79	130	QM SAS requirements	The Exposure Draft references 'Other New Requirements' which apparently clarifies what an engagement partner needs to review and which are significant judgments and significant matters. We believe that generally the engagement partner is closer to the specifics of an audit engagement and is able to use his or her experience and judgment in determining what items need to be reviewed by the partner more so than the standard setters. This is true in general and especially relevant in smaller, less complex engagements handled by smaller firms.	Noted
80	65	QM SAS AM	Yes	Noted
81	71	QM SAS AM	The Group is neither agrees or disagrees with the changes described in – Proposed QM SAS - Overall Matters. It is unclear on how the application material for No. 1 links to the requirement in AU-C Section 700. Overall, it is difficult to find the application material that relates to the changes in the Proposed QM SAS related to this question. Cross references would be helpful when asking about the application material.	Noted
82	76	QM SAS AM	NO	Noted
83	102	QM SAS AM	QM SAS is clear and understandable.	Noted
84	121	QM SAS AM	4c. Yes, the application material in proposed QM SAS is helpful in supporting the application of the requirements. See the response to 4b. above for a recommendation with respect to implementation and other nonauthoritative guidance.	Noted
85	123	QM SAS AM	Given the exclusion of government audit organization from applying statements on quality management standards, we appreciate paragraph 2's specific inclusion of this standard to audits conducted by government audit organizations that perform financial audits in accordance with generally accepted auditing standards.	Noted
86	65	QM SAS AM	The ED information is consistent with my former Firm's policies and procedures.	Noted
87	146	QM SAS AM	Yes, the application material is helpful.	Noted
88	156	QM SAS AM	Yes, based on our initial reading of QM SAS.	Noted
89	162	QM SAS AM	Yes, we believe the overall application material in the QM SAS are overall clear and understandable.	Noted
90	103	QM SAS AM/paragraph A29	"Scalability (paragraph A29 of the proposed QM SAS) – We recommend providing additional guidance on the level of formality of the communication among the engagement team.	For implementation material

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
91	40	QM SAS AM/par. A35	We also suggest clarifying the difference between unconscious and conscious auditor biases in QM SAS paragraph A35.	No change, in existing GAAS. Also plain English meanings apply.
92	10	QM SAS AM/Par. A38	Paragraph A38 uses the term “listed entities” when it states “For example, certain requirements related to independence may be applicable only when performing audits of listed entities”. Use of this term does not align with the AICPA Code of Conduct and its inclusion is inconsistent with other areas of the proposed standards where similar references were deleted for jurisdictional purposes.	Agree, delete or replace with relevant example.
93	10	QM SAS AM/Par. A44	Paragraph A44 deletes the example from the IESBA Code contained in the international quality management standard. We believe this is an opportunity to reference the conceptual frameworks embedded in the AICPA Code of Conduct as an alternative example that is relevant to practitioners in the US. There are a number of examples in the AICPA Code of Conduct that could be provided, such as those in section 1.295 Non-attest Services which highlights several “safeguards” that are required.	Agree, example provided
94	10	QM SAS AM/Par. A45	Paragraph A45 provides reference to SQMS No. 1 regarding the establishment of policies and procedures for breaches of relevant ethical requirements. Section 1.298 Breach of an Independence Interpretation of the AICPA Code of Conduct also contains specific requirements regarding appropriate response to breaches of independence. We believe it would be helpful to include reference to the relevant AICPA Code of Conduct requirements.	Such examples better provided in QM1.

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
95	10	QM SAS AM/Par. A48	<p>Paragraph A48 could be interpreted to imply that government audit organizations are exempt from relevant ethical requirements and may, instead, take a threats and safeguards approach. We believe the intent is that there is an expectation that government audit organizations comply with the relevant ethical requirements except in certain limited circumstances. We suggest clarifying the language to reflect this intent as follows.</p> <p>A48. <u>Government audit organizations are expected to comply with the relevant independence requirements of the AICPA Code of Conduct except in certain limited circumstances.</u> Law or regulation may provide require safeguards for the independence of governmental audit organizations and the auditors they employ. However, in the absence of law or regulation, governmental audit organizations may establish supplemental safeguards to assist the auditor or audit organization in maintaining independence. Additionally, when law or regulation does not permit withdrawal from the engagement, the auditor may disclose in the auditor’s report the circumstances affecting the auditor’s independence.</p>	From extant, no evidence that this is being misinterpreted. No change.
96	40	QM SAS AM/ Par. A85	In proposed QM SAS paragraph A85, item 2, refer to paragraph A35 instead of paragraph A34.	Agree, corrected.
97	143	QM SAS AM\Par. A116	<p>D&amp;T believes the edit to paragraph A116 to consider firm policies and procedures that [may] set forth required actions, is not correct. In such circumstances the engagement partner takes into account the firm policies and procedures and responds accordingly. The use of the term “considering” implies that the engagement partner has flexibility and in doing so may, or may not, consider the policies and procedures, including the related requirements.</p> <p>A116. ... In addition to <del>considering</del> <u>taking account of</u> firm policies or procedures that may set forth the required actions to be taken in such circumstances, appropriate actions that the engagement partner may take, include, for example....</p>	Agree, changed “considering” to “applying”
98	143	QM SAS AM\	<p>Paragraphs A25, A91, and A107</p> <p>It is recommended that the wording in paragraph A25 of proposed QM SAS revert to that of paragraphs A25, A91, and A107 in ISA 220 (Revised).</p> <p>Paragraph A99</p> <p>D&amp;T notes the inclusion of the phrase “such as those that required significant auditor attention” (which is not in ISA 220 (Revised)) to further describe circumstances when consultation may be required relating to significant risks. We believe that, by their nature, significant risks require the focused attention of the auditor; therefore, this phrase does not</p>	<ul style="list-style-type: none"> <li>• Without further justification for this recommendation, no change to ASB direction.</li> <li>• Agreed</li> </ul>

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			<p>add any further clarity to the application material. D&amp;T recommends that the phrase be deleted.</p> <p>Paragraph A115</p> <p>D&amp;T believes that the changes to paragraph A115 of proposed QM SAS when compared with ISA 220 (Revised) are unnecessary and are not the result of circumstances that are unique to the United States environment. Consequently, these should be reversed.</p>	<ul style="list-style-type: none"> <li>Revised from ISA for clarity and ease of reading; no change.</li> </ul>
99	83	QM SAS/Par. 2	<p>We suggest the Board provide clarification within the QM SAS that government audit organizations are subject to the quality control and assurance requirements of Government Auditing Standards. This is stated in paragraph 5 of the introduction to the proposed SQMS No. 1, but incorporating the language into the proposed QM SAS would provide additional clarity.</p>	<p>This paragraph is from extant but could be strengthened. See proposed revision.</p>
100	143	QM SAS requirements\Par agraph 2	<p>D&amp;T believes that it would be helpful to enhance the auditors’ understanding of paragraph 2 of proposed QM SAS by clarifying the following:</p> <p>Financial audits of governmental entities conducted in accordance with GAGAS may be performed by either auditors of a firm or [government] auditors within a government audit organization. The proposed SAS is applicable to auditors in government audit organizations because GAGAS incorporates by references the SASs (Chapters 2.13 and 6.01 of GAS).</p> <p>Identifying which quality management standards are, in fact, applicable to auditors in government audit organizations.</p> <p>The AICPA code is generally applicable to auditors, including auditors in government audit organizations, conducting financial audits in accordance with GAGAS. This is outlined in chapters 2.14 and 3.05 of GAS and ET section 1.000.02 of the AICPA code.</p> <p>D&amp;T also notes that the wording in paragraph 2 of proposed QM SAS is not entirely consistent with paragraph 5 of proposed SQMS No. 1. It is not clear whether proposed QM SAS is applicable to “auditors in government audit organizations” or to “government audit organizations” as stated in paragraph 5 of proposed SQMS No. 1.</p> <p>D&amp;T recommends the following, including, as outlined in our response to Question 1 above, a reference to the requisite professional literature, or an interpretation thereof where it states that the proposed SQMSs are not applicable to auditors in government audit organizations:</p> <p><b><u>2. Financial audits of governmental entities conducted in accordance with Government Auditing Standards (GAS) may be performed by auditors of a firm or auditors in government audit organizations. For auditors complying with generally accepted government auditing standards (GAGAS), the proposed Statements on Quality Management Standards (SQMSs) are applicable to auditors of a firm; however, the proposed</u></b> Although Statements on Quality Management Standards (SQMSs) are not applicable to auditors in government audit organizations. <b><u>As GAGAS</u></b></p>	<p>See proposed revision to par. 2</p>

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			<p><b><u>incorporates by reference the SASs (footnote 1), this proposed SAS is also applicable to auditors in government audit organizations who perform conduct financial audits of governmental entities in accordance with GAAS GAGAS. In addition to the ethical principles in the GAS (footnote 2), other ethical requirements or codes of professional conduct may be applicable when conducting financial audits of governmental entities in accordance with GAGAS, including the AICPA code (footnote 3).</u></b></p> <p align="center"> <b><u>Footnote 1: Chapter 2.13, GAS.</u></b>  <b><u>Footnote 2: Chapters 2.14 and 3.05, GAS.</u></b>  <b><u>Footnote 3: ET section 1.000.02 of the AICPA code.</u></b> </p>	
101	161	QM SAS\Par. A90-A94	<p>Consideration should also be given to adding an example specific to group audits, to explain how the group engagement partner needs to seek assistance from the component partner and describe the role the component audit firm’s policies and procedures play. We are not proposing a suggestion here as such guidance will depend on how ISA 600 is drafted, including how the concepts such as the component auditor’s written acknowledgment of the group audit instructions and the component auditor’s overall summary memorandum or report describing the work performed and the results thereof are articulated.</p>	<p>No change; because such guidance depends on how 600 is drafted, this suggestion will be provided to the Group Audits Task Force.</p>
1	161	QM SAS Overall\Specific comments	<p>Overview</p> <p>As noted in our cover letter, we support the intent of the revisions to promote consideration of risks to quality at the engagement level and support many of the revised requirements in the proposed SAS. We agree that the engagement partner needs to be sufficiently and appropriately involved throughout the audit to be able to take overall responsibility for the quality of the engagement. However, as audits become more complex and audit delivery models to support quality audits evolve, it is often necessary to involve others to assist the engagement partner in directing, supervising, and reviewing the engagement. The concept of other partners assisting the engagement partner is contemplated in the definition of an “audit partner” in Rule 2-01 of Regulation S-X, which addresses not only requirements for the lead partner, but also other audit engagement team partners (including those who serve as the lead partner in connection with an audit of subsidiaries of an issuer) who have responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements. PCAOB AS 1201, Supervision of the Audit Engagement, clearly articulates the concept of other engagement team members who assist the engagement partner with supervision of the work of other engagement team members. In practice, these “auxiliary partners” are an essential part of bringing quality to engagements of varying sizes and complexities,</p>	<p>Concerns noted for implementation guidance. Also see last three rows of this table.</p>

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			<p>including in the case of group audits. In our experience, using auxiliary partners to assist the (lead) engagement partner is necessary in light of the volume of work to be reviewed - we believe that having other suitably qualified individuals involved in directing, supervising, and reviewing elements of the overall engagement supports enhanced quality, and does not diminish the (lead) engagement partner’s responsibility for the engagement as a whole. While we understand that the IAASB’s project on ISA 220 is intended to be responsive to concerns from regulators outside the US that the engagement partner may not always be appropriately involved in the audit, we do not believe there are similar concerns in the US that would merit a significant overhaul of extant AU-C section 220.</p> <p>We believe that, as drafted, the level of prescription regarding the lead engagement partner’s responsibilities in some of the proposed new requirements is in conflict with the premise in paragraph 8 that the engagement partner may need to assign the design or performance of some procedures, tasks, or actions to other members of the engagement team, especially in an audit of an entity whose nature and circumstances are more complex. In our view, it is generally not possible or practicable for the lead engagement partner to satisfy all of the requirements of the QM SAS by themselves. Although the application material provides examples of how the requirements can be applied in certain situations, we are concerned with how the proposed QM SAS seems to shift from extant AU-C section 220’s requirements for the engagement partner to be satisfied regarding certain matters to a more robust requirements for the engagement partner to “determine” and “review” a broader range of matters. We do not believe the application material overcomes the prescriptive nature of the revised requirements. Further, we believe that use of the terms “determine” and “review” is not clear in the context of the requirement outlined in paragraph 9 of the proposed QM SAS. We believe that the lack of specificity as to what it means to “determine” or “review” may result in varied interpretations in practice as to how such requirements are performed and documented within the audit file.</p> <p>We therefore believe the proposed SAS should more clearly describe the concept of assignment of responsibility to others to assist the engagement partner in fulfilling their quality responsibilities, and take steps to further highlight how the requirements within the standard would be applied in various circumstances (e.g., through additional application material or implementation guidance). In principle, we believe that the engagement partner should be able to assign responsibility for aspects of quality to those most qualified to deliver on it. In addition, many audit delivery models have been put in place to specifically</p>	

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			<p>reinforce quality through quality control procedures embedded in their design, including firm policies and procedures. Accountability for different aspects of audit quality in an engagement can, in our view, be shared with others when all participants understand their role and how it is interrelated with those of others. Firm policies and procedures are best suited to address such roles and responsibilities.</p> <p>In building a framework that best supports audit quality, it is important that the requirements in the proposed QM SAS are grounded in a risk-based approach, and are sufficiently principles-based so that they can be appropriately applied across a variety of engagement team structures in a scalable manner. We offer more specific concerns about circumstances in which the proposed QM SAS will be applied and recommendations to alleviate these concerns below.</p> <p>Recognizing the evolving nature of how audits are conducted</p> <p>Today’s audits are being performed with increasingly diverse and distributed delivery models that leverage technology, other tools, and working practices to increase the efficiency and effectiveness of audit work. Further, the impact of the COVID-19 pandemic continues to highlight the need for different structures to bring quality to an engagement, including flexibility in how the principles of adequate direction, supervision, and review can be achieved. So it is timely that the ASB considers how to acknowledge these changing structures in the proposed QM SAS, as we expect to continue to see an increase in engagements using Centers of Excellence, service delivery centers, staff augmentation models, and other audit delivery models across the profession. The primary objective of these audit delivery models is to drive higher quality through consistent performance. While paragraph A15 appropriately acknowledges that engagement team members may be located together or across different geographic locations and may be organized in groups by the activity they are performing, our view is that the proposed SAS downplays the importance of shared accountability for quality by establishing unduly prescriptive requirements for the engagement partner to individually perform and misses an opportunity to further modernize the standards in light of current developments.</p> <p>In our experience, these newer audit team structures rely on robust policies and procedures established at the firm level and are designed to mitigate perceived risks of the engagement partner delegating responsibilities for direction, supervision, and review. For example, these</p>	

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			<p>policies and procedures ordinarily set out responsibilities for interactions between the engagement partner (or an auxiliary partner) and partners and others with supervisory responsibilities using various audit delivery models, as well as specify what audit documentation is to be reviewed by whom, including what should be reviewed by the engagement partner and how such review should be evidenced. These new and evolving models also leverage technology to facilitate direction, supervision, and review, which is also addressed by the firm’s policies and procedures through its SoQM. Consistent with the proposed SAS, the engagement partner remains ultimately responsible for quality at the engagement level, but quality is brought to bear by the appropriate involvement of others.</p> <p>Challenges with how the concepts have been articulated in the proposed SAS and suggestions for further clarity</p> <p>We are concerned that the proposed SAS may not be capable of being effectively implemented in light of the various audit delivery models that may exist today and how such models (and the technology that supports their functioning) are likely to evolve in the future. It is important that the proposed SAS reflect the changing nature of audits and not introduce prescriptive requirements that may impede, rather than support, audit quality. Specifically, we believe that there are a number of potentially significant unintended consequences of aspects of the proposed changes, as described below. We have identified certain of these concerns in connection with our efforts to commence implementation of ISA 220, and are aware of the IAASB’s plans to develop further implementation guidance in relation to practical considerations that were raised in the development of ISA 220. We believe the ASB should seek to address these concerns before finalizing the proposed QM SAS, with a view to avoiding unnecessary differences with the PCAOB’s standards. Similarly, it is important the ASB fully considers the impact that the proposed QM SAS will have on group audits and its planned efforts to revise AU-C section 600 once the IAASB finalizes its project.</p> <p>Given the evolving audit environment, we believe that it is important that the standard recognizes that various ways exist to direct, supervise, and review audit engagements, and encourages the use of professional judgment in making this determination. We believe that the requirements in the proposed SAS are potentially overly prescriptive, considering the increasingly dynamic engagement team structures to which the proposed SAS will be</p>	

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			<p>applied.</p> <p>Paragraph A10 of the proposed SAS acknowledges that ordinarily, the engagement team may depend on the firm’s policies and procedures in complying with the requirements of the proposed SAS, and paragraph 9 notes the engagement partner may need to obtain information from or assign certain procedures or tasks to other suitably experienced members of the engagement team to be able to fulfill particular responsibilities set forth in the proposed SAS. We believe these concepts should be made more prominent in the proposed SAS, and potentially implementation guidance, to assist auditors in understanding how the proposed SAS can be applied to various structures. We provide drafting suggestions in Appendix 2 to this letter.</p> <p>In particular, we believe there will likely be practical challenges arising from how the requirements in the following paragraphs have been drafted, or possible inconsistencies in how such requirements are applied in different audit structures (including group audits, as described in more detail below) given the inference that these tasks are to be solely performed by the engagement partner:</p> <p>Paragraph 25: requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the team in a timely manner</p> <p>Paragraph 26: requires the engagement partner to determine that members of the engagement team and others collectively have the appropriate competence and capabilities, including sufficient time, to perform the engagement</p> <p>Paragraph 30: requires the engagement partner to determine that the nature, timing, and extent of direction, supervision, and review is planned and performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements, and are responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team by the firm</p> <p>Paragraph 31: requires the engagement partner to review audit documentation related to significant matters, significant judgments, and other matters</p>	

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			<p>Paragraph 35: requires the engagement partner to determine that consultations have been appropriately undertaken, and conclusions agreed and implemented</p> <p>Paragraph 38: requires the engagement partner to determine that conclusions related to differences of opinion are documented and implemented</p> <p>Paragraph 39: requires the engagement partner to determine the relevance and effect on the audit engagement of information from the firm’s monitoring and remediation process, including, as applicable, information from the monitoring and remediation process of the network and across the network firms</p> <p>The ASB should evaluate whether changes to the requirements or additional application material is necessary to clarify how the engagement partner would comply with the objective of these requirements when other suitability qualified members of the engagement team are significantly involved in direction, supervision, and review, as well as the important interaction with the firm’s quality responses, including its policies and procedures with which its personnel are expected to comply.</p>	
102	143	QM SAS Overall\Specific comments re: Group audits	<p><i>Changes to Paragraphs Affecting Group Audits</i></p> <p>Although D&amp;T understands the desire to make certain changes to proposed SQMS No. 1 and proposed QM SAS in order to provide additional examples or enhance the clarity of proposed QM SAS relating to group audits, given the current ongoing project to amend ISA 600 (Revised), <i>Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)</i>, and the companion work effort currently being undertaken by the ASB pertaining to AU-C section 600, <i>Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)</i> (AU-C 600), we believe that any related changes to proposed SQMS No. 1 and proposed QM SAS should be considered as conforming amendments when AU-C 600 is exposed for comment. This will allow for the conforming amendments to be considered in the appropriate context and avoid the possibility of multiple updates to group audit-related paragraphs in the proposed QM standards to reflect a finalized AU-C 600.</p>	Agree
103	161	QM SAS Overall\Specific	Seeking assistance from the component partner and other component engagement team members	To be addressed as part of Group Audit project,

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		<p>comments re: Group audits</p>	<p>In order to take responsibility at the group engagement level, the (group) engagement partner will need to rely on actions being taken by the engagement partner at the component as well as the component firm’s policies and procedures. Our experience suggests that the group engagement team member needs assistance from the partner in charge of the component team to comply with a number of requirements, particularly in relation to relevant ethical requirements, engagement resources, and monitoring and remediation. We believe this is appropriate and in the best interests of quality, as the presumption would be that the partner would be an appropriately skilled or suitably experienced member, with visibility into the firm’s policies and procedures that govern the component team’s work.</p> <p>In practice, we believe the group engagement partner is able to “take responsibility” or make “determinations” contemplated by the proposed QM SAS based on review of the component auditor’s written acknowledgment of the group audit instructions and the component auditor’s overall summary memorandum or report describing the work performed and the results thereof, supplemented with two-way communication throughout the audit as any issues may arise. The policies and procedures at both the group engagement team’s firm and the component auditor’s firm also play a significant role, in particular when both firms are members of the same network with a common methodology. On the other hand, when the component auditor is from a non-network firm, without additional guidance, it is difficult to envisage how certain of the requirements can be practically undertaken by the group engagement partner, for example understanding results of monitoring and remediation of a non-network firm (paragraph 39 of the proposed QM SAS). In such circumstances, we believe there may be conflicts with national laws or regulations governing confidentiality and potential limitations on what can reasonably be expected to be shared with the engagement leader, in particular about another firm’s SoQM.</p> <p>As another example, paragraph 35 of the proposed SAS requires the engagement partner to determine that members of the engagement team have undertaken appropriate consultation during the audit engagement and that conclusions have been agreed and implemented. It is not practicable to expect that the group engagement partner would be aware of how the component auditor’s firm sets out consultation requirements nor whether individuals within the component audit team have followed those requirements</p>	<p>including any amendments to be proposed to QM SAS.</p>

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			<p>and appropriately executed the consultation. In a complex group audit, this could extend to a number of matters. Rather, the principle of shared accountability would suggest that the component partner make an assertion to this effect (i.e., thereby providing information to the group engagement partner to be used in making this determination). We have similar concerns with paragraph 38 in relation to differences of opinion at the component level. We are concerned that without additional implementation guidance suggesting how such requirements can be practically implemented, auditors may become unduly focused on less important matters at the expense of audit quality.</p> <p>Definition of engagement team</p> <p>We understand that, in the context of a group audit, the revised definition of engagement team is intended to scope in all individuals involved in performing work at components of the group (i.e., component auditor teams, which would include individuals from network and non-network component auditors). We believe this has significant implications for the expectations of a group engagement partner that we do not believe have been sufficiently evaluated.</p>	
104	161	QM SAS\Par. A90-A94	<p>Consideration should also be given to adding an example specific to group audits, to explain how the group engagement partner needs to seek assistance from the component partner and describe the role the component audit firm’s policies and procedures play. We are not proposing a suggestion here as such guidance will depend on how ISA 600 is drafted, including how the concepts such as the component auditor’s written acknowledgment of the group audit instructions and the component auditor’s overall summary memorandum or report describing the work performed and the results thereof are articulated.</p>	<p>No change; because such guidance depends on how 600 is drafted, this suggestion will be provided to the Group Audits Task Force.</p>
105	161	QM SAS\Par. A90-A94	<p>Discussion of significant judgments</p> <p>We agree that the engagement partner would ordinarily review the most critical areas of judgment related to a specific audit engagement, including those relating to difficult or contentious matters, understanding that firm policies and procedures may allow auxiliary partners to perform detailed reviews of significant judgments (including at components). We agree with the guidance in paragraph A92 of the proposed SAS that the firm’s policies or procedures may specify certain matters that are commonly expected to be significant judgments - this is often the case to drive consistency in execution. Paragraph A92 also</p>	<p>See row 109.</p>

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			<p>appropriately recognizes that the engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. It is important that the proposed SAS notes that whether or not the examples in paragraph A92 are significant judgments will also depend on the facts and circumstances of the engagement. See drafting suggestions in Appendix 2. This flexibility will also be important from the perspective of engagement quality reviews as described in our response to Question 3.</p>	
106			<p>Documentation</p> <p>We believe there is a significant risk of confusion and inconsistent application of the requirements due to the use of the term “determine” within the requirements. In certain cases, the “determination” appears to be a “stand back requirement” or a “final consideration.” From the use of this terminology, the extent of documentation required to support the engagement partner’s determination, and how that should be evidenced within the audit workpapers, is unclear. We believe that additional application guidance in relation to specific requirements would be helpful as to how the engagement partner or the engagement team more broadly may be reasonably expected to evidence their determination within the audit file on these key matters. We are concerned that the use of terminology like “determine” or “evaluate” will result in an expectation that detailed documentation will be included, which may not improve quality. This concern is not specific to the proposed SAS, and suggests the ASB may need to more fundamentally revisit how documentation requirements are explained in the AU-Cs, as this has been highlighted as a concern from a scalability perspective.</p> <p>To illustrate, paragraph 4 requires the engagement team to determine whether to design and implement responses at the engagement level beyond those in the firm’s policies and procedures. As currently worded, such a determination may imply that the engagement partner documents a specific conclusion that no additional responses beyond the firm’s policies and procedures are necessary. For example, in accordance with paragraph 36:</p> <p>Where an engagement quality review is required, is there an expectation that the determination that an engagement quality reviewer has been appointed include a specific requirement for the engagement partner to document the rationale for the appointment, rather than relying on the firm’s policies and procedures alone?</p>	<p>Noted for implementation and application guidance.</p>

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Row	CL <sup>1</sup>	Node	Coded Text	Task Force Comments
			<p>Correspondingly, if an engagement does not meet the firm’s criteria for an engagement quality review, the requirements in paragraph 4 may suggest that the engagement partner would need to explicitly document the factors taken into account in considering whether to request an engagement quality reviewer be assigned.</p> <p>We also suggest more guidance is needed to clarify what evidence would need to be documented to support the engagement partner’s determination in accordance with paragraph 40 that the engagement partner’s involvement has been sufficient and appropriate throughout the audit engagement such that the engagement partner has the basis for determining that the significant judgments made and the conclusions reached are appropriate given the nature and circumstances of the engagement, and the nature and circumstances of the audit engagement, any changes thereto, and the firm’s related policies or procedures have been taken into account in complying with the requirements of the proposed SAS. We believe the audit file itself will support this determination and the purpose of the requirement is for the engagement partner to reflect before issuing the audit report, rather than to perform a comprehensive assessment of the engagement or drive additional documentation. The ASB could consider specifically addressing this in paragraph A118 of the proposed QM SAS.</p>	
107	161	QM SAS requirements\ Par. 8-9	<p><u>7A. Quality management at the engagement level is supported by the firm’s system of quality management and informed by the specific nature and circumstances of the audit engagement. Ordinarily, the engagement team depends on the firm’s policies and procedures in complying with the requirements of this proposed SAS. Direction and supervision of the engagement team and the review of the work of the engagement team are firm-level responses that are implemented at the engagement level, of which the nature, timing, and extent may be further tailored by the engagement partner in managing the quality of the audit engagement. [Elevated from paragraphs A4 and A82]</u></p> <p>9. The engagement partner remains ultimately responsible and, therefore, accountable, for compliance with the requirements of this proposed SAS. <u>Engagement teams may be organized in a variety of ways. For example, engagement team members may be located together or across different geographic locations and may be organized in groups by the activity they are performing, or may be performing group audits in accordance with AU-C section 600. Accordingly, the engagement partner may often find it necessary to seek assistance from appropriately skilled or suitably experienced members of the engagement team to fulfill the responsibilities pursuant to this proposed SAS.</u> The phrase “takes</p>	<p>TF does not agree with moving this material from AM to introductory material. Second sentence would be new.</p> <ul style="list-style-type: none"> <li>• See row below</li> </ul>

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			<p>responsibility for..." is used for those requirements for which the engagement partner is permitted to <u>assign responsibility for aspects of engagement quality (for example, to seek assistance with direction, supervision, and review of the audit engagement)</u><del>assign the design or performance of procedures, tasks, or actions to appropriately skilled or suitably experienced members of the engagement team.</del> For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled by the engagement partner, <del>and</del> <u>In such circumstances, the engagement partner may often need to obtain information from the firm or other members of the engagement team in order to fulfill that responsibility. For example, when other appropriately skilled or suitably experienced engagement team members perform supervisory and review responsibilities (including at a component in the context of a group audit), the engagement partner's determination takes into account the outcome of those activities.</u> (Ref: Para. A21A–A24) [Note: Concept of seeking assistance from others leveraged from PCAOB AS 1201, additional language added to describe how others are likely to assist in practice, including group audits, material elevated from paragraph A15]</p> <p><b>Scalability</b></p> <p><u>9A8.</u> The requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each audit. Examples follow:</p> <p>a. When an audit is carried out entirely by the engagement partner, which may be the case for an audit of a less complex entity, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of other members of the engagement team. (Ref: par. A13– A14)</p> <p>b. When an audit is not carried out entirely by the engagement partner or in an audit of an entity whose nature and circumstances are more complex (<u>including a group audit</u>), the engagement partner may <u>need to seek assistance from</u> <del>assign the design or performance of some procedures, tasks, or actions to</del> other members of the engagement team <u>to fulfill the responsibilities set out in this proposed SAS.</u> [Edits to align with the concepts in paragraph 9.]</p>	
108	161	QM SAS requirements\Paragraph 25 and AM	<p>Engagement Resources</p> <p>25. The engagement partner should determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner, taking into account the nature and circumstances of the audit engagement, the firm's policies or procedures, <del>and</del> any changes that may arise during the engagement <u>and</u>,</p>	Task Force believes that all the edits proposed, in the aggregate, overemphasize the point and could diminish the engagement partner's understanding of

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			<p><u>as necessary, input from others who are assisting with responsibilities for direction, supervision, and review.</u> (Ref: par. A59–A70, A73–A74, and A79) [Edits to align with the concepts in paragraph 9 to highlight the view that input from others will often be necessary, in particular in a group audit.]</p> <p>26. The engagement partner should determine that members of the engagement team, and any auditor’s external specialists and internal auditors who provide direct assistance who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. <u>This determination takes into account the firm’s policies and procedures and, as necessary, input from others who are assisting with responsibilities for direction, supervision, and review.</u> (Ref: par. A62 and A71–A74) [Edits to align with the concepts in paragraph 9 to highlight the view that input from others will often be necessary, in particular in a group audit.]</p> <p><i>Sufficient and Appropriate Resources to Perform the Engagement</i> (Ref: par. 25)</p> <p>A70. In determining whether sufficient and appropriate resources to perform the engagement have been assigned or made available to the engagement team, ordinarily, the engagement partner may depend on the firm’s related policies or procedures (including resources) as described in paragraph A6. For example, based on information communicated by the firm, the engagement partner may be able to depend on the firm’s technological development, implementation, and maintenance programs when using firm-approved technology to perform audit procedures.</p> <p><u>A70A. The engagement partner may often find it necessary to seek assistance from others who are assisting with responsibilities for direction, supervision, and review to make the determinations required by paragraphs 25-27 of the proposed SAS. For example, in the case of a service delivery center, the partner or other senior engagement team member may be best placed to determine whether personnel at the service delivery center have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. If there is a concern with engagement resources at the service delivery center, such concerns would be communicated to the engagement partner and addressed as necessary in accordance with the firm’s policies and procedures.</u></p>	<p>their responsibility. Task Force agreed to add first sentence proposed as par. A70A, and noted to address service centers in implementation/application guidance.</p>

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			<p><u>A70B. Similarly, in the case of a group audit, communication with the partner responsible for overseeing work at the component will likely be necessary to make this determination, for example in the form of an acknowledgment (see also paragraph A76).</u></p>	
109	161	QM SAS \Paragraph 30-34 and AM	<p>30. The engagement partner should determine that the nature, timing, and extent of direction, supervision, and review is (Ref: par. A81–A89 and A94–A97)</p> <ul style="list-style-type: none"> <li>a. planned and performed in accordance with the firm’s policies or procedures, professional standards, and applicable legal and regulatory requirements, and</li> <li>b. responsive to the nature and circumstances of the audit engagement and the resources assigned or made available to the engagement team by the firm.</li> </ul> <p><u>This determination takes into account, as necessary, input from others who are assisting with responsibilities for direction, supervision and review. [Edits to align with the concepts in paragraph 9 to highlight the view that input from others will often be necessary, in particular in a group audit.]</u></p> <p>The Engagement Partner’s Review (Ref: Par. 30-34)</p> <p>A90. As required by AU-C section 300, the engagement partner reviews the overall audit strategy and audit plan. As required by AU-C section 230, the engagement partner documents the date and extent of the review. <u>As noted in paragraph A63, technological resources may be used to effectively manage the audit, for example, a tool that illustrates assigned workflow may evidence the preparation of an appropriate plan for the effective direction, supervision, and review of planned audit procedures.</u></p> <p>A91. Timely review of documentation by the engagement partner at appropriate stages throughout the audit engagement enables significant matters to be resolved to the engagement partner’s satisfaction on or before the date of the auditor’s report. The engagement partner need not review all audit documentation. <u>In conjunction with the firm’s policies and procedures,</u> the engagement partner exercises professional judgment in determining the extent of documentation to be reviewed, for example, when determining the nature and extent of the review of component auditor documentation in a group audit.</p> <p>A92. The engagement partner exercises professional judgment in identifying the areas of significant judgment made by the engagement team. The firm’s policies or procedures <u>often</u></p>	See comment above. Task Force believes the proposed revisions to application material are too granular.

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			<p><del>may</del> specify certain matters that are commonly expected to be significant judgments, <u>what is expected to be documented in relation to them, and who is expected to review such judgments (including whether others with supervisory responsibilities can assist the engagement partner with their review)</u>. Significant judgments in relation to the audit engagement may include matters related to the overall audit strategy and audit plan for undertaking the engagement, the execution of the engagement, and the overall conclusions reached by the engagement team. <u>Depending on the facts and circumstances of the engagement, examples follow of matters that may be considered significant judgments include:</u></p> <p>[no changes suggested to bulleted list]</p> <p>A94. The nature, timing, and extent of the direction, supervision, and review are required to be planned and performed in accordance with the firm’s policies or procedures, as well as professional standards and applicable legal and regulatory requirements. For example, the firm’s policies or procedures may include the following:</p> <ul style="list-style-type: none"> <li>c. Work planned to be performed at an interim date is to be directed, supervised, and reviewed at the same time as the performance of the procedures, rather than at the end of the period, so that any necessary corrective action can be taken in a timely manner.</li> <li>d. Certain matters are to be reviewed by the engagement partner, and the firm may specify the circumstances or engagements in which such matters are expected to be reviewed. <ul style="list-style-type: none"> <li>• <u>When others are permitted to assist the engagement partner with their review of the matters in paragraph 31, how the reviews may be executed, including how technology may be utilized.</u></li> </ul> </li> </ul> <p><u>A94A. The granularity of reviews by an engagement partner is influenced by the experience of other reviewers and the extent of their review. An engagement partner may make judgments regarding the appropriate extent of assistance requested of other partners in areas of significant judgments in the audit. Such other partners may perform a more detailed review of the underlying audit documentation of the work performed and discuss the outcome of this review with the engagement leader to enable the engagement partners to fulfill the requirement in paragraph 30 of this proposed SAS.</u></p>	

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			<p><u>A94B. Similarly, service delivery centers may be used to execute certain components of the audit plan. Where audit work is performed using service delivery centers, firm policies and procedures may provide guidance to assist the engagement partner in satisfying the direction, supervision, and review requirements included in paragraph 31. Consideration of facts and circumstances and the application of firm policies and procedures may assist the engagement partner in determining the nature, timing, and extent of the engagement partner's review.</u></p>	