Group Audits: Discussion Memorandum and Issues

Discussion of Comment Letter Responses to "Requests for Comment" in the Exposure Draft of the Proposed SAS *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors*)

I. Objectives of Agenda Item 3

To provide the Auditing Standards Board (ASB) with preliminary feedback from the comment letters received on the March 23, 2022, exposure draft of 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*) and to obtain direction from the ASB on certain matters.

II. Group Audits Task Force

The following are the 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

The proposed SAS addresses audits of group financial statements and, if issued as a final SAS, would supersede extant AU-C section 600 *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)*. It is intended to strengthen the auditor's approach to planning and performing a group audit and to clarify the interaction of the proposed SAS with the other AU-C sections, including AU-C section 220, *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards,* AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement,* and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence.* In developing and updating its standards, one of the strategic objectives of the ASB is to converge its standards with those of the International Auditing and Assurance Standards Board (IAASB), while taking into consideration the standards of other standard setters, such as the Public Company Accounting Oversight Board (PCAOB) and the U.S. Government Accountability Office (GAO). The proposed SAS is based on International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors*), which was approved at the December 2021 IAASB meeting and issued in April 2022.

IV. Agenda Materials

Agenda Item 3	Group Audits: Discussion Memorandum and Issues
Agenda Item 3A	Summary of Comments on Proposed SAS *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-To Auditors)*

Agenda Item 3B	The March 23, 2022, exposure draft 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)*
Agenda Item 3C	PCAOB AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm,* per PCAOB Adopting Release No. 2022-002 dated June 21, 2022
Agenda Item 3D	Appendix B, *Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results*, of PCAOB AS 1105, *Audit Evidence*, per PCAOB Adopting Release No. 2022-002 dated June 21, 2022
Agenda Item 3E	AU-C 501, *Audit Evidence — Specific Considerations for Selected Items*

Ms. Burzenski will use agenda item 3 for discussion purposes. In addition, Ms. Burzenski will provide a verbal summary to the board on the recently adopted PCAOB standards related to other auditors.

High Level Summary of Comment Letter Feedback

The ASB received 22 comment letters on the exposure draft (ED) of the proposed SAS, which seeks specific feedback from respondents on 13 different topics identified in the ED under the headings "Request for Comment."

Overall, the responses to the ED were supportive of moving forward with convergence with ISA 600 (Revised), subject to further revisions to the ED to address comments received. Of note is that a number of respondents believe that certain aspects of the proposed SAS should be aligned with PCAOB Release No. 2022-002.

Issues for ASB Consideration

The Group Audits Task Force (Task Force) is seeking direction from the ASB on the following four issues:

Issue 1: Auditing components that are equity method investments (EMIs) and consideration of alignment with PCAOB standards.

Issue 2: Structure of proposed standard related to referred-to auditors and consideration of alignment with PCAOB standards.

Issue 3: Considering the magnitude of the portion of the financial statements audited by referred-to-auditors in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained (par. A41 of the ED).

Issue 4: Recommendation for PEEC to align with the IESBA project and to clarify independence requirements for group audits.

The four issues above are discussed in this memo. All of the detailed responses to the requests for comment in the ED are contained in Agenda Item 3A.

The Task Force will more fully consider the comments received on the ED and bring an analysis of comments and recommendations to the ASB for consideration at the October 2022 ASB meeting.

Issue 1: Auditing Components That are Equity Method Investments (EMIs) and Consideration of Alignment with PCAOB Standards

Request for Comment 9: Components That Are Equity Method Investments

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

Question 9: Do you agree with the application material in paragraphs A47–A49 of the proposed SAS relating to a noncontrolling interest in an entity that is accounted for by the equity method?	No. of Responses
Yes	12
No	6
No comment	4
No. of comment letters	22

Question 9: Are there additional requirements or application material relating to EMIs that are needed in the proposed SAS, and if so, what should they be?	No. of Responses
Additions needed	9
OK as is	6
No comment	7
No. of comment letters	22

Summary of Commenter Responses
(Note that the summary of responses have been reworded for brevity; see Item 3A for complete wording.)

Four commenters (E&Y, GT, PWC, and KPMG) commented on the alignment of the proposed SAS with PCAOB standards. In particular, they note the audit evidence that can be obtained from audited financial statements as well as the challenges encountered by group auditors in establishing an arrangement with the auditor of an EMI under which the group auditor would direct and supervise the activities of the auditor of the EMI and review that auditor's work. These commenters generally recommended that the ASB align the proposed SAS with Appendix B, "Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results," of AS 1105, *Audit Evidence,* as amended in PCAOB Release No. 2022-002 so that:

- If the audited financial statements of the EMI (including the accompanying auditor's report) are determined to constitute sufficient appropriate audit evidence, the auditor of the EMI would not be considered a component auditor (i.e., not part of the engagement team), and therefore, the group auditor would not be required to direct and supervise the auditor of the EMI or review that auditor's work.

- If the financial statements of the EMI are audited, the group auditor would be required to read the financial statements of the EMI and the accompanying auditor's report, perform limited procedures to determine whether the report is satisfactory for the group auditor's purpose, and if it is satisfactory, may be able to conclude that the financial statements and the auditor's report constitute sufficient appropriate audit evidence. These procedures are similar to those related to investments in securities when valuations are based on the investee's financial results in extant AU-C section 501, *Audit Evidence – Specific Considerations for Selected Items*.

- If in the auditor's professional judgment additional audit evidence is needed, the group auditor would be required to perform procedures to gather such evidence.

Additionally:

- Three commenters requested that the ASB consider adding guidance that addresses situations in which no assurance exists relative to the EMI's financial statements (i.e., the EMIs did not obtain separate audits). (NSAA, MI OAG, COV) One commenter would like to see additional guidance, such as a materiality threshold, on whether a failure to obtain information would be considered a scope limitation, also noting that reverting to the cost basis is not appropriate. (TXCPA)

- One commenter indicates that a group auditor should only be following the guidance in paragraph A48 of the proposed SAS if the group financial statements include a noncontrolling interest in an entity that is accounted for by the equity method investment (which reflects a risk of material misstatement to the group financial statements) and the group auditor's access to information or people at the entity is restricted. The commenter is concerned that a group auditor may interpret the paragraph to mean that, even if they do not have specific access restrictions at the entity, they can directly apply A48 and obtain audited financial statements for the equity method investment and "take credit" for the substantive audit work performed on the equity method investment, without any interactions with the auditor of the equity method investment. To contribute to more consistent performance by group auditors, the commenter recommends that examples be provided to illustrate how differences in the risk assessment may impact the procedures performed by the group auditor. (Crowe)

- Two commenters believe paragraph A49 of the proposed SAS should be removed or updated because it suggests that restrictions on access to information or people of the equity method investee is an indicator that challenges management's assertion with regard to accounting for the investment under the equity method (management's assertion about the extent of influence it has on the EMI). Current accounting guidance regarding EMIs does not address restricted access in determining the extent of influence. The paragraph may be read to mean that the standard introduces additional considerations in determining the application of accounting standards. (CLA, Eide Bailly)

- In relation to EMIs, one commenter believes there should be consideration of a separate concept of component performance materiality. For example, an EMI that is 30% owned by the group should not have a component performance materiality of a comparative 100% owned component, as the risk of aggregated misstatements and risk of material misstatement represented by the 30% ownership is significantly less than another component of the same size. Expansion on determining component performance materiality for EMI would be helpful. (SL)

For ease of reference, the application material in paragraphs A47–A49 of the proposed SAS is as follows:

> **A47.** In some circumstances, the group auditor may be able to overcome restrictions on access to information or people. Examples follow:
>
> - 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 noncontrolling interest in an entity that is accounted for by the equity method, the group auditor may determine whether provisions exist (for example, 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 noncontrolling 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 noncontrolled entity, the group auditor may inquire whether they can provide financial and other information available to them in these roles.

A48. If the group has a noncontrolling 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, from the following:

- Financial information that is available from group management because group management also needs to obtain the noncontrolled 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 noncontrolled 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 auditor's report on the group financial statements

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.

A49. If the group has a noncontrolling 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.

The amended Appendix B, "Audit Evidence Regarding Valuation of Investments Based on Investee Financial Results," of PCAOB AS 1105, *Audit Evidence,* has been provided to the Board as Agenda Item 3D.

Additional Information

Prior to extant AU-C 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors*) becoming effective in 2012, the AU-Cs contained requirements that were similar to the PCAOB's (i.e., the ability to use audited financial statements as audit evidence for an investment accounted for using the equity method similar to investments in securities when valuations are based on the investee's financial results in extant AU-C section 501, *Audit Evidence — Specific Considerations for Selected Items* -see Agenda Item 3E). With the issuance of extant AU-C 600, it was clarified that equity method investments were considered "components", and paragraph AU-C 600.A23 elaborates on the ability to use audited financial statements as audit evidence, as follows:

A23.When access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a component that is accounted for by the equity method of accounting. If the component is not a significant component and the group engagement team has a complete set of financial statements of the component, including the auditor's report thereon, and has access to information kept by group management regarding that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence regarding that component. If the component is a significant component, however, and the auditor of the group financial statements is not making reference to the audit of a component auditor in the auditor's report on the group financial statements, then the group engagement team will not be able to comply with the requirements of this section that are relevant in

the circumstances of the group audit. For example, the group engagement team will not be able to comply with the requirement in paragraphs .57–.58 to be involved in the work of a component auditor. Therefore, the group engagement team will not be able to obtain sufficient appropriate audit evidence regarding that component. The effect on the auditor's report of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of section 705, Modifications to the Opinion in the Independent Auditor's Report.

Question for the ASB:
1. Does the Board want the Task Force to align the requirements related to EMIs in the proposed SAS with PCAOB AS 1105, Appendix B?
2. If the Board wants to align with the requirements of the PCAOB, does the Board want to remove EMIs from the Proposed SAS and update AU-C 501 to address EMIs?

(Note that there were additional comments and suggestions unrelated to this question to the Board, that will be addressed by the Task Force at a future date.)

Issue 2: Practicality of Certain Requirements Related to Referred-to Auditors and Consideration of Alignment with PCAOB Standards

Request for Comment 10: Retaining the Option to Make Reference

Question 10. Do you support retaining the option that exists in extant AU-C section 600 for the group engagement partner to make reference to the audit of a referred to auditor (a component auditor per extant AU-C section 600) in the auditor's report on the group financial statements?	No. of Responses
Yes	19
No comment	3
No. of comment letters	22

Request for Comment 11: Requirements Related to Referred-to-Auditors

Question 11. Are the specific requirements relating to referred to auditors clear, appropriate, and easily identifiable within the proposed SAS, including when considering exhibit A?	No. of Responses
Yes	13
Yes with suggestions	3
No	2
No comment	4
No. of comment letters	22

Two of the 18 commenters who responded to question 11 believe that the requirements are not clear, appropriate, or easily identifiable for the following reasons:

- The commenter struggled to identify the requirements that would apply when component auditors and referred-to auditors are involved without reliance on the exhibit. To enhance the readability and ease of use, the commenter suggested that the ASB consider the following options:
  - Issue a separate standard that includes the requirements and application material for circumstances in which reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements: The PCAOB took this approach in its proposal [and also in its final standard], since the referred-to auditor has a different level of supervision than an "other auditor" (a term that is akin to component auditor) and is not part of the engagement team.

  - Present the requirements for circumstances in which reference is made to the audit of a

referred-to auditor in the auditor's report on the group financial statements as a separate section within the SAS: Though this would create some repetition in the proposed standard (i.e., requirements that apply to both the involvement of component auditors and referred-to auditors), it would enhance the clarity of the requirements and application when using a referred-to-auditor. (EY)

- The requirements in the proposed SAS appear to be more restrictive than the requirements in AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm,* in PCAOB Release 2022-002 when dealing with referred-to auditors. AS 1206 does not contain a requirement to communicate significant risks to referred-to auditors, while the proposed SAS requires that the group auditor communicate significant risks that are relevant to the referred-to auditor. There may be practical challenges with this and other requirements (e.g., determining that referred-to auditors have the appropriate competence and capabilities) based on the level of access and communication the group engagement team is able to have with a referred-to auditor. In the PCAOB's proposed standard, there are inquiries of, and representations from, the referred-to auditor; however, the expectation of the two-way dialogue between the group auditor and the referred-to auditor is substantially less than what would be anticipated between the group auditor and the component auditor. (PwC)

- The commenter questions whether the effort required by the proposed SAS is necessary for nonissuers audited under ASB standards as compared to issuers audited under PCAOB standards. Because the concept of referred-to auditors is unique to the US environment, the commenter encourages the ASB to seek closer alignment with the PCAOB in setting its requirements. (PwC)

- The construct of the standard results in a level of repetition that might render it unclear. Clarifications to the wording and ordering of certain requirements would better follow the flow of the audit process and assist the auditor's judgment in first deciding whether it is appropriate to make reference, and then how to do so. The commenter believes that the ASB could seek to reduce the degree of duplication between a number of requirements, specifically in relation to independence and relevant ethical requirements, offers some drafting suggestions in Appendix 2 of its comment letter, but believes there may be further opportunities to streamline. (PwC)

Background on the Issue

Recap of Prior Board Meetings
During the July 2021 Board Meeting, the Board discussed the following:

- Retaining the option in extant AU-C 600 for the group auditor to make reference to the audit of a component auditor in the auditor's report on group financial statements (making reference)
- The conclusion by the Task Force that the main paragraphs in extant AU-C 600 (paragraphs 24-31 and related application material) that address making reference do not need revision, and that other paragraphs within extant AU-C 600 that mention making reference do not need revision (other than conforming changes as a result of converging with ISA 600).

The Board agreed with the direction stated in the two bullets above.

At the October 2021 Board Meeting, the direction to the Task Force from the Board was to consider developing a separate proposed SAS that would be applicable only when the group auditor is making reference, to make it clear that the requirements that are applicable when making reference generally differ from the requirements that are applicable when the group auditor is assuming responsibility.

At the January 2022 Board Meeting, the Task Force informed the Board that, 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 standard) and instead included all the paragraphs related to making reference (except for a very few) together in one section towards the end of a single proposed SAS. This approach does the following:

- Accomplished the objective of the ASB
- Enabled 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
- Eliminated the potential confusion that might exist concerning which SAS applies in which circumstance, considering the proposed SAS focused on group audits as a whole (e.g., it includes requirements and guidance on risk assessment and performing further auditor procedures, while the recent PCAOB standards focus on the use of other auditors (i.e., mainly the direction and supervision of other auditors)
- Resulted in a streamlined and easy to follow standard, both when assuming responsibility and also when making reference

The Board was in agreement with the proposed approach.

PCAOB Requirements When Making Reference
On June 21, 2022, the PCAOB adopted AS 1206, *Dividing Responsibility for the Audit with Another Accounting Firm*. Agenda Item 3C has been provided to the Board and is a replication of AS 1206.
In addition to AS 1206, the PCAOB also adopted additional amendments to AS 2101, *Audit Planning*, that are applicable when dividing responsibility, as follows:

> .11 In an audit of the financial statements of a company with operations in multiple locations or business units, the auditor should determine the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient appropriate evidence to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. This includes determining the locations or business units at which to perform audit procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual locations or business units. The auditor should assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk of material misstatement associated with that location or business unit.
>
> .12 Factors that are relevant to the assessment of the risks of material misstatement associated with a particular location or business unit and the determination of the necessary audit procedures include:
>
> a. The nature and amount of assets, liabilities, and transactions executed at the location or business unit, including, e.g., significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") executed at the location or business unit;
>
> b. The materiality of the location or business unit;
>
> c. The specific risks associated with the location or business unit that present a reasonable possibility of material misstatement to the company's consolidated financial statements;
>
> d. Whether the risks of material misstatement associated with the location or business unit apply to other locations or business units such that, in combination, they present

a reasonable possibility of material misstatement to the company's consolidated financial statements;

e. The degree of centralization of records or information processing;

f. The effectiveness of the control environment, particularly with respect to management's control over the exercise of authority delegated to others and its ability to effectively supervise activities at the location or business unit; and

g. The frequency, timing, and scope of monitoring activities by the company or others at the location or business unit.

Note: When performing an audit of internal control over financial reporting, refer to Appendix B, *Special Topics*, of AS 2201 for considerations when a company has multiple locations or business units.

.13 In determining the locations or business units at which to perform audit procedures, the auditor may take into account relevant activities performed by internal audit, as described in AS 2605, *Consideration of the Internal Audit Function*, or others, as described in AS 2201. AS 2605 and AS 2201 establish requirements regarding using the work of internal audit and others, respectively.

.14 In an audit that involves other auditors or referred-to auditors, the lead auditor should perform the procedures in paragraphs .11–.13 of this standard to determine the locations or business units at which audit procedures should be performed.

Additionally, Section 4140, "Principal Auditor," of the SEC's *Financial Reporting Manual* also has additional guidance that is applicable in a scenario where reference is being made in the audit report an issuer to another auditor. The various PCAOB standards that address group audits (or multilocation audit engagements) illustrate the different structure used by the PCAOB in comparison to the proposed SAS, which aligns with international standards.

Commenter Views

Based on analysis of the comment letters, the following was noted:

- One commenter (EY) appears to suggest following the PCAOB's approach of placing the requirements for situations in which the auditor is making reference in a separate standard.
- One commenter (PWC) appears to suggest that the proposed SAS should align more closely with PCAOB AS 1206.

The Task Force notes that commenters had additional suggestions on the flow of the paragraphs related to making reference, as well as drafting suggestions. The Task Force intends to analyze and address these comments at a future meeting.

Questions for the ASB

1. Does the Board continue to agree with the approach taken in the proposed SAS as it relates to incorporating the requirements for making reference in a single SAS (i.e., a separate SAS applicable only when making reference is not necessary)?
2. Does the Board want the Task Force to either:
   a. Explore aligning the requirements related to making reference in the proposed SAS with PCAOB AS 1206? As there are areas where differences exist between the proposed SAS and AS 1206, how does the Board suggest the Task Force proceed in making determinations as to which differences should remain or which differences are eliminated?
   b. Maintain the approach of keeping the requirements related to making reference consistent with the extant standard, adjusted only as necessary to be consistent with the proposed

SAS?

Issue 3: Considering the Magnitude of the Portion of the Financial Statements Audited by Referred-to Auditors in Determining Whether Sufficient Appropriate Audit Evidence Can Reasonably be Expected to be Obtained

Request for Comment 12: Considering Magnitude of Portion of Financial Statements Audited by Referred-To-Auditor When Determining Whether Sufficient Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained

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

Explanation: The last sentence of par. A41 of the ED states, "As the magnitude of the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained."

Question 12: Is the last sentence of paragraph A41 clear?	No. of Responses
Yes	5
Yes with suggestions	1
No	13
No comment	3
No. of comment letters	22

Question 12: Is there additional application material that is needed, and if so, what should it be?	No. of Responses
OK as is	3
Additions	9
No comment	10
No. of comment letters	22

Summary of Commenter Responses

Thirteen of the nineteen commenters who responded to this question indicate that the last sentence of par. A41 is not clear and provided the following additional comments about that sentence:

- Five commenters found this sentence to be problematic because, in the government auditing environment, it is not uncommon for referred-to auditors to perform a substantial percentage of the audit work. They believe that, if the procedures outlined in paragraphs 51 – 66 related to making reference are adhered to and adequately documented, there is no reason why magnitude alone should imply that sufficient appropriate audit evidence could not be obtained by the group engagement partner. (COV, MI OAG, NSAA, VSCPA, Eide Bailly)

- Two commenters suggested that the ASB add a "Consideration Specific to Governmental Entities" paragraph to address the magnitude concept with relation to opinion units in a governmental environment or expand paragraph A43 to more clearly address magnitude considerations related to opinion units. (COV, MI OAG)

- To avoid diversity in practice, four commenters recommended that a better delineation be made (in numbers or words) to identify where the threshold is for concluding that the group engagement partner cannot make reference to a referred-to auditor. (E&Y, TXCPA, OSCPA, CLA). One commenter suggested that the SAS provide a figure as a starting point in the SAS to help drive

consistency in practice and noted that consistency is especially relevant, as this matter involves the coordination of different firms. The commenter recommended that the following language from par. .06A of PCAOB AS 2101, *Audit Planning,* be added: (E&Y)

> In addition, in an audit that involves referred-to-auditors, the participation of the engagement partner's firm ordinarily is not sufficient for it to serve as lead auditor if the referred-to-auditors, in aggregate, audit more than 50 percent of the company's assets or revenues.

Commenters requested clarification or application guidance regarding the following matters:

- Certain qualitative factors can be important considerations for determining whether the group auditor can obtain sufficient appropriate audit evidence on which to base an opinion on the group financial statements Provide additional considerations for the group engagement partner, such as the location of group operations and group management, and the extent of the group engagement team's knowledge of the overall financial statements and familiarity with the group. (GT)

- Clarify that the group engagement partner's assessment of the magnitude of the portion of the financial statements audited by the referred-to auditor includes quantitative and qualitative (emphasis added) considerations relating to the financial information and disclosures that could reasonably be expected to influence the economic decisions of users of the group financial statements. (BDO)

- To avoid a strictly monetary interpretation of magnitude, add a phrase to the final sentence that incorporates the need to consider the qualitative magnitude of risks vs. solely the quantitative magnitude of the portion of the financial statements audited by the referred-to auditors. (TIC)

- Both extant AU-C section 600 and the first bullet in paragraph A41 of the proposed SAS use the term "financial significance." It is unclear if "magnitude" is intended to have a different meaning from "financial significance" and, if so, what that meaning is. Additional, or revised, application material clarifying the intended meaning of "magnitude" would add to greater understanding of the intent of paragraph A41. (Mazars)

- Clarify whether the considerations in par. A41, including the financial significance of the components and risks of material misstatements to the group financial statements associated with the components, also apply when component auditors are involved. Clarify whether there would ever be an instance where the component audited by a component auditor would be too significant, as determined by various criteria, for the group auditor to obtain sufficient appropriate evidence. (E&Y)

Question for the ASB

1. When considering the magnitude of the portion of the financial statements audited by referred-to auditors in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, which of the following should the Task Force explore?
    a. Developing additional application guidance addressing both quantitative and qualitative factors for the group auditor to evaluate when considering the magnitude or the portion of the financial statements audited by referred-to auditors? If so, what are those additional factors?
    b. Specifying a "bright-line" quantitative threshold for the group auditor to use when considering the magnitude or the portion of the financial statements audited by referred-to auditors (e.g., PCAOB AS 2101.06A has a threshold of 50%)?

Issue 4: Recommendation for PEEC to Align with the IESBA Project and to Clarify Independence Requirements for Group Audits

Unrelated to a specific request for comment in the ED, five commenters (Deloitte, EY, GT, KPMG, PWC) provided comments related to an ongoing International Ethics Standards Board for Accountants (IESBA) project.

In February 2022, the IESBA released the Exposure Draft *Proposed Revisions to the Code Relating to the Definition of Engagement Team and Group Audits* (IESBA ED), with proposed revisions to the International Code of Ethics for Professional Accountants (the IESBA Code). The proposed revisions establish provisions that comprehensively address independence considerations for firms and individuals involved in an engagement to perform an audit of group financial statements. The proposals also address the independence implications of the change in the definition of *engagement team*, a concept central to an audit of financial statements, in ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*. Among other matters, the proposals do the following:

- Establish new defined terms and revise a number of existing terms, including for application with respect to independence in a group audit context

- Clarify and enhance the independence principles that apply to
    - individuals involved in a group audit.
    - firms engaged in the group audit, including firms within and outside the group auditor firm's network.

- More explicitly set out the process to address a breach of an independence requirement at a component auditor firm, including reinforcing the need for appropriate communication between the relevant parties and with those charged with governance of the group.

- Align a number of provisions in the Code to conform to changes in the IAASB's Quality Management standards.

Commenters acknowledged the status of the IESBA project and provided the following urgent recommendations:

- The Professional Ethics Executive Committee ("PEEC") of the AICPA should actively monitor the IESBA project.

- PEEC should undertake a project to revise the AICPA's Code of Professional Conduct and evaluate convergence with the IESBA Code.

- The ASB and PEEC should consider the interaction of the IESBA ED and the proposed group audit SAS as it relates to compliance with ethical requirements, including those related to independence, particularly with regard to non-network component auditors involved in a group audit.

Questions for the ASB

1. Does the Board agree that it is urgent for the ASB and PEEC to engage in order to respond to the commenter recommendations?
2. What are the Board's views on the timeline and ability to vote on a final standard, and whether there are dependencies on PEEC actions (e.g., a PEEC exposure draft)?
3. If yes, how does the ASB wish to proceed in engaging with PEEC?
4. If yes, how does the ASB wish for Task Force to proceed in assisting the ASB to engage with PEEC?