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FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE

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Mr J. Sylph
Technical Director
International Auditing and
Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York,
NY 10 017 - USA

Subject: Comment on the Exposure Draft of the revised and redrafted ISA 600 "The Audit of Group Financial Statements" – March 2006

Dear Mr Sylph,

1. We appreciate the opportunity to comment on a revised and redrafted version of the International Standard on Auditing 600 - The Audit of Group Financial Statements.
2. We welcome IAASB's work in developing a new standard on group audits. That said, we have a number of comments that you will find attached in the Annex, and key comments which we offer below:
 - (a) **The principle of the sole responsibility of the group auditor should be underpinned**

We fully concur with the IAASB's stance that the group auditor is responsible in all circumstances for the group audit opinion, a position which is along the lines of Article 27(a) of the Directive 2006/43/EC on statutory audit. However, when reading the exposure draft, this crucial assertion is to be found nowhere but in paragraph 4 of the Introduction. We believe that the status of the introduction in ISAs does not sufficiently underpin the importance of the assertion, and therefore we strongly support moving paragraph 4 to the requirement section.

In addition this paragraph also needs clarification in two ways. Firstly, the current reference to the responsibility of other auditors involved in the group audit is unclear, since it could be misinterpreted as an attempt to alter the group auditors' responsibility. Secondly, the paragraph should specify further what the sole responsibility of the group auditor entails in terms of requirements. For instance, it may underline that the group auditor only shall decide how to plan and perform the work on the consolidated financial statements, including the extent of his involvement in the audit of components.

(b) **The respective duties of the group auditor and the other auditor towards each other should be clarified**

In a world of global operations, cross-border audits of groups may span well beyond the group auditor's jurisdiction. The ISAs will in many circumstances be the group auditor's sole instrument enabling him to fulfil his responsibility over the group financial statements. Since the group auditor depends on other auditors to perform his duties, one should expect ED ISA 600 to require the group auditor to obtain from the other auditors, confirmation of their adherence to the professional standards stemming from ISAs, their compliance with ethical requirements relevant in the context of a group audit performed in accordance with ISAs, and their commitment to cooperate with the group auditor in the context of the group auditor's responsibility. To be effective, such commitments should be obtained at an early stage, e.g. at the planning stage. This should in our opinion be reflected in paragraphs 14 and 39.

This ISA insufficiently addresses the interplay between the group auditor's understanding of the group and of its components, his understanding of the other auditors, and how to respond to this. Paragraph 15 should offer more solutions allowing scaling the group auditor's response depending on his understanding of other auditors. Paragraph 26 should mention the existence of this interrelationship and paragraph 20 be underpinned by further guidance.

(c) **Access to the other auditor's working papers should be better addressed**

Only considering access to the other auditor's audit documentation, as currently foreseen in paragraph 14(d), is not enough to guarantee such access. To be consistent with paragraph 14(d), ISA 600 should contain the requirement for an other auditor to confirm at an early stage in the audit process that he will grant access to the group auditor to all the necessary information, including working papers etc, and that the features of such access have been mentioned in the engagement letter at component level (as stated in A11, bullet points 5 and 6). This would be necessary to align ISA 600 with Article 27(b) and (c) of Directive 2006/43/EC, which require the group auditor respectively to review the audit work performed by others, and to get access to work papers of other auditors for the benefit of the competent authorities of a Member State.

Paragraph 14(d) should then acknowledge that there may be legal impediments to the access to the other auditor's work papers. This is foreseen by Article 27(c) of Directive 2006/43/EC. Such impediment, usually relating to confidentiality or data privacy laws, should not prevent *a priori* relying on the other auditor's work. Paragraphs A8 and A11 could spell out the details of the consequences of such impediments on the group audit.

(d) **ISA 600 should further specify how the group auditor plans and implements the audit of the group as a whole**

The interplay between ISA 600 and the other ISAs is unclear, particularly with respect to the following:

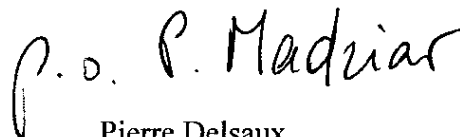
- planning at group audit level (link to ISA 300),
- understanding and assessing the risks at group audit level (a group audit plan should be designed in accordance with ISA 315), and
- responding to the assessed risks at group audit level (link to ISA 330),

We encourage the IAASB to develop further a requirement for an overall group strategy and audit plan, and to clarify the interplay between standards as mentioned above.

In addition, the ISA should address in a more robust way the audit of the consolidation process itself, and include verifying whether the group's financial statements comply with the scope of consolidation specified by the applicable accounting framework. We suggest adapting accordingly the section on "Consolidation process".

3. The general comments made in our letter of 13 March, 2006 on Clarity are also applicable with respect to the revision and redrafting of this exposure draft of ISA 600.
4. I would like to recall that this comment letter cannot pre-empt any future official position of the European Commission on the topic of ISAs or any other topic.
5. The comments in this letter have taken account of the views expressed within the European Group of Auditors' Oversight Bodies (EGAOB), and within subgroup 'ISA' of the EGAOB. The 'ISA' subgroup is comprised of participants from European organisations including audit regulators, standard setters on auditing, professional bodies, and companies. Those comments may not necessarily reflect in all circumstances the unanimous views of the members of the EGAOB and/or of the participants to the EGAOB 'ISA' Sub-group'.

Yours sincerely,



Pierre Delsaux
Acting Director

Enclosures: Appendix: Detailed comments

Appendix: Detailed comments

Q1A THE PROPOSAL TO ELIMINATE THE DISTINCTION BETWEEN RELATED AND UNRELATED AUDITOR GAVE RISE TO SUBSTANTIAL CHANGES TO SOME OF THE PROPOSED REQUIREMENTS. RESPONDENTS ARE ASKED TO INDICATE WHETHER THEY ARE IN AGREEMENT WITH THE PROPOSAL, AND THE EFFECT THAT IT HAS ON THE PROCEDURES THAT THE GROUP AUDITOR PERFORMS IN RELATION TO THE WORK OF OTHER AUDITORS.

- 1.1. We strongly support the removal of any distinction between related and unrelated auditors.
- 1.2. We however believe that this deletion warrants the need for the IAASB to consider further three key aspects:
 - the respective duties of the group auditor and the other auditor towards each other,
 - the group auditor's reliance on the other auditor, and
 - the group auditor's involvement in the audit of components.

Respective duties of the group and the other auditor towards each other

- 1.3. Please refer to point 2(b) of the cover letter.

Group auditor's reliance on the other auditor

- 1.4. Paragraphs 14 and 15 are key elements of this ISA in terms of assessing the ability of the other auditors to fulfil what is expected from them by the group auditor. We consider that more emphasis needs to be given to the system of audit regulation in the country.
- 1.5. A new class of 'audit regulators' is being promoted in a number of jurisdictions, and not only in the EU: the auditors' public oversight bodies. Paragraph 14 tends to ignore this key aspect. Paragraph A13 does not seem prominent enough in this respect. We believe that considering whether there is a robust regulatory environment constitutes one of the most important features in the assessment of an other auditor that should be included for consideration in paragraph 14.
- 1.6. Access to the other auditors' audit documentation: please refer to point 2(c) of the covering letter.

Group auditor's involvement in the audit of components

- 1.7. In responding to identified issues arising from paragraph 14, paragraph 15 seems to offer no other solution to the group auditor than rejecting the other auditor's work. The standard should develop more solutions to allow better scaling the group auditor's response proportionally to any issues identified. This may include e.g. considering the consequences of the identified shortcomings overall, having a deeper involvement of the group auditor into the audit of components by performing part of the work himself, etc. The Board may develop a range of possible alternative responses the exhaustion of which would then only finally prevent the group auditor from relying in any way on the work of the other auditor and lead him to consider performing himself all the work on the related components.

- 1.8. There is an interplay between the group auditor's understanding of the group and its components, the understanding of the other auditors, and the work undertaken by the group auditor. We noticed however that this interrelationship is insufficiently reflected in the exposure draft, particularly in section Responding to Assessed Risks. We suggest the following remedies:
- to develop Application Material for paragraph 20 in order to describe the appropriate responses to the varying circumstances encountered and the scale of the issue. These circumstances would typically relate to the significance of the component, the identified significant risks, the group auditor's understanding of the other auditors, work performed by the other auditors, and access to the other auditor's documentation;
 - to develop guidance to assist the group auditor in deciding which procedure to choose from the list provided in paragraph 22 in responding to assessed risks on significant components; and
 - to add the words "and their interrelationship" to the second sentence of paragraph 26.

Q1B RESPONDENTS ARE ASKED ALSO TO CONSIDER THE PROPOSED DEFINITIONS OF "GROUP AUDITOR," "MEMBER OF THE ENGAGEMENT TEAM UNDER THE DIRECT SUPERVISION OF THE GROUP ENGAGEMENT PARTNER," AND "OTHER AUDITOR OR ANOTHER AUDITOR."

- 1.9. Under EC legislation, the group auditor is either a statutory auditor (natural person) or an audit firm¹. Key audit partners are defined as those who are primarily responsible for carrying the group audit, and those involved in the audit of material subsidiaries². As currently drafted, the definition of a group auditor in paragraph 7(d) of ISA 600 risks creating inconsistencies with the Directive 2006/43/EC on Statutory Audit in two aspects:
- In ISA 600, the group auditor is primarily defined as the engagement partner and his team, i.e. as natural persons who may be working on behalf of an audit firm. The audit firm as such is left out.
 - In ISA 600, the second sentence of paragraph 7(d) tends to make members of the engagement team responsible for the tasks devolved to the group auditor, a statement which might contradict EC legislation³ and paragraph 4 of ED 600 on the group auditor's sole responsibility.
- 1.10. We therefore suggest the IAASB examine a solution referring to the words 'group auditor' only when dealing with overall responsibilities and duties involving the engagement partner(s) alone or the audit firm. We suggest defining and using a new term 'group audit team' where the engagement partner, together with the engagement team directed and supervised by the

¹ Article 2(6) of Directive 2006/43/EC

² Article 2(16) of Directive 2006/43/EC

³ Article 27(a) of Directive 2006/43/EC

engagement partner alone, or either one, can perform the procedures foreseen by the ISA.

Q2 WHERE A GROUP AUDITOR TAKES SOLE RESPONSIBILITY FOR THE AUDIT OPINION ON THE GROUP FINANCIAL STATEMENTS, IT WILL REQUIRE THAT THE GROUP AUDITOR OBTAINS SUFFICIENT APPROPRIATE AUDIT EVIDENCE ON WHICH TO BASE SUCH AN OPINION. IT IS NECESSARY TO BE REASONABLY SPECIFIC ABOUT THE STEPS TO BE TAKEN, AND THE WORK EFFORT REQUIRED, BY THE GROUP AUDITOR. DO RESPONDENTS THINK THAT THIS APPROACH IS JUSTIFIED?

2.1. We believe that the IAASB has taken the right stance but has not gone far enough.

Understanding the group and its risks and responding to assessed risks

2.2. One would expect the group auditor to always perform the necessary procedures to understand the group, assess the risk of material misstatements at group level, and respond, at group level, to the assessed risks. The way ISA 600 interplays with ISA 300, ISA 315 and ISA 330 is however not clear. ISA 600 should require the group auditor to prepare a group audit plan in accordance with ISA 300, to make a risk assessment at group level according to the procedures of ISA 315 (paragraphs 16 and 17), and respond to the assessed risks in accordance with ISA 330 (paragraphs 20 and 21).

2.3. We therefore support requiring an overall group strategy and audit plan addressing these issues.

2.4. ISA 600 should also require the group auditor to "step back" and determine whether the audit work performed at the component level meets the overall intended level for the scope of work at group level. In this respect, paragraph 42 should specify that the assessment of audit evidence should also take account of *the work performed at group level*.

Scope of work undertaken for the consolidation process

2.5. Group financial statements bear significant risks in virtually all engagements. They include adjustments and eliminations which are non-routine journal entries, often with a significant impact on the financial statements. The audit of the consolidation process itself is a key element in preparing group financial statements. The overall group strategy and audit plan referred to above should specifically address this topic.

2.6. The audit of the consolidation scope (i.e. compliance with the accounting framework) is also a crucial procedure. The extent of work relating to the consolidation process itself, as compared to the other requirements in the ISA, does not seem to reflect its significance. We believe that the description of the group auditor's work in these respects may be developed further in paragraph 31 with a two-step approach:

- first, the group auditor should perform procedures to obtain an understanding of the controls regarding consolidation, and test the operating effectiveness of the controls. These procedures should contain, e.g. an evaluation of the group accounting manual, group instructions for consolidation and component financial statements;

- second, the group auditor should assess the completeness and accuracy of (i) the components included in the consolidation, and of (ii) the consolidation adjustments and eliminations; and

Aim and scope of analytical reviews

- 2.7. We support more flexibility in section "Responding to Assessed Risks for Components that Are Not Individually Significant", when determining the work to be performed on components that are not selected for particular work. We do not support for instance that for each insignificant component, analytical procedures be systematically performed at group level. However before deciding not to perform any procedures, the auditor should at least assess whether the component is not likely to give rise to material risks or risks of fraud at the group level.
- 2.8. Such flexibility may however be framed by a requirement according to which the group auditor ensures that each component falling in this category is reviewed at least periodically.

Q3A WITH REGARD TO THE APPLICATION OF THE PROPOSED CLARITY DRAFTING CONVENTIONS, IS THE OBJECTIVE TO BE ACHIEVED BY THE AUDITOR, STATED IN PARAGRAPH 6 OF THE PROPOSED ISAs, APPROPRIATE?

- 3.1. We have previously provided detailed comments on the drafting and consistency of Objectives. We invite the IAASB to take full account of our letter of 13 March 2006 on the Exposure draft "Improving the Clarity of IAASB standards".
- 3.2. As currently drafted, the Objective section stresses too much on a summarised list of requirements. The objectives should put even more emphasis on the outcome of the group audit, including e.g. on the ability to express an audit opinion. We would also support referring to the fact that the group auditor may obtain audit evidence from other auditors to reach the objective.

Q3B WITH REGARD TO THE APPLICATION OF THE PROPOSED CLARITY DRAFTING CONVENTIONS, HAVE THE GUIDELINES IDENTIFIED BY THE IAASB FOR DETERMINING WHETHER A REQUIREMENT SHOULD BE SPECIFIED BEEN APPLIED APPROPRIATELY AND CONSISTENTLY, SUCH THAT THE RESULTING REQUIREMENTS ARE AT A LEVEL THAT PROMOTES CONSISTENCY IN PERFORMANCE AND THE USE OF PROFESSIONAL JUDGMENT BY AUDITORS?

Clarity and proportionality

- 3.3. We believe that the guidelines have generally been consistently applied. Further comments are made below in this respect.
- 3.4. Several terms are unclear in a number of instances.. This is for example the case with such wording as "shall be involved" (paragraph 27), "where considered necessary" (paragraph 26), "significant work" (paragraph 19) or "shall be satisfied" (paragraph 9). We invite the IAASB to clarify the meaning of these.

Communication between the group auditor and the other auditor

- 3.5. The burden of a group auditor in reviewing reporting items from an other auditor can increase dramatically if reported matters include elements that are not specifically useful for the purpose of the group audit. The IAASB should make it clearer that, in relation to communication with, and reporting from an other auditor, it should be sufficient to only communicate the information that is relevant for the purpose of the group audit. However, the other auditor should report insignificant issues that might, in aggregate - e.g. because they are likely to be repeated throughout the group a result of a group procedures manual -, or if combined with other information, have a material effect at group level.
- 3.6. The communication between an other auditor and the group auditor may be in the form of oral communication. The group auditor should be required to, at least, document such communication in the audit files when it is relevant for the purpose of reaching conclusions as to the group audit.
- 3.7. The format imposed by paragraphs 39 and 40 on an other auditor's memorandum to the group auditor appears too systematic and may end up imposing a burden in some cases without corresponding benefits. The requirement may specify that each section shall be addressed, but that an other auditor may not report in the cases of 'not applicable' or 'not significant' sections or issues.
- 3.8. In addition, paragraph 39(h) appears to be incomplete as, at present, it only deals with matters that an other auditor 'wishes' to draw to the attention of the group auditor. Instead, it should read:

"(h) Set out any other matters which could have an impact on the group auditor's expression of opinion, according to the other auditor, or that the other auditor wishes to draw to the attention of the group auditor;"

Q4 OTHER COMMENTS

- 4.1. In the case of statutory audits, paragraphs 12 and 13 do not offer sufficient flexibility to the group auditor to complete the engagement, even in the case of a foreseeable disclaimer. In particular, there may be circumstances beyond management's control where it may be in the public interest for the auditor to complete the engagement rather than resigning. This could be reflected in paragraph 13 as follows: "When an audit of group financial statements is required by statute or regulation it is in the interests of the users of those financial statements to be made aware of the limitations in scope preventing the group auditor forming an opinion. In such circumstances, the group auditor should accept the engagement and express a disclaimer of opinion on the group financial statements in accordance with ISA 705 and 706".