

NZAuASB Board Meeting Summary Paper

AGENDA ITEM NO. 9.1
Meeting date: 5 December 2019
Subject: ISA 600 (Revised) Group Audits
Date: 22 November 2019
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Item Objectives

1. The objective of this agenda item is for the Board to:
 - Receive an update on the proposed changes to International Standard on Auditing (New Zealand) 600 (Revised), *Group Audits* to be discussed by the IAASB at its December meeting.

Background

2. In its September 2019 meeting, the IAASB discussed, among other matters, the updated public interest issues, a draft of a significant part of the standard and the ISA 600 Task Force's proposals with respect to the scope and structure of the standard, materiality considerations in a group audit and a proposed stand-back requirement. A summary of the discussions was included in the IAASB September meeting report provided to the Board in the October 2019 meeting.
3. The ISA 600 Task Force has now taken the IAASB's September comments into account in preparing a revised draft of the standard. The IAASB is due to consider these proposed changes in its upcoming meeting in December 2019.
4. This Agenda item includes a summary of the Task Force's most recent proposed changes to ISA 600. For those of you interested in more details about the proposed changes, the most recent draft of ISA 600 marked up against the version reviewed by the IAASB in its September meeting is available at agenda item 9.2. Please note it is not required reading.

Update on proposed changes by the Task Force

5. The following table shows the areas the IAASB directed the Task Force to consider providing further guidance and clarity on for consideration at the December meeting.

The IAASB feedback in September 2019	The Task Force response since September 2019
The scope of the standard. Specifically, the use of the consolidation process in defining "component," and whether there might be group financial statements that are prepared through a process other than a consolidation process.	The Task Force included additional application material to specifically address the situation when a single entity aggregates the financial information of branches or divisions using processes other than a consolidation process. I.e. where the accounting for the branches or divisions is performed centrally within a single general ledger, and there is no separate financial information for the branches or divisions that requires aggregation. ISA 600 (Revised)

	<p>now clarifies that the group audit is not applicable to such circumstances.</p>
<p>How the group auditor accesses information or people in a group audit, particularly in jurisdictions where such access is limited by law or regulation, and what the group auditor should do if unable to gain access.</p>	<p>In response to the IAASB feedback, the Task Force concluded that the most appropriate time to address access issues is when auditors agree the terms of audit engagements with the entity. Consequently, the Task Force has proposed to include specific requirements in ISA 600 to prompt the engagement partner to obtain agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence.</p> <p>The Task Force also added a new requirement, for the group engagement partner, when accepting a group audit, to consider the effect on the audit when group management cannot provide the engagement team with unrestricted access to persons within the group due to restrictions that are outside the control of group management.</p> <p>The Task Force is also proposing to refocus the application material on how to overcome access restrictions. This includes:</p> <ul style="list-style-type: none"> • Explanations that highlights access to people and information can be restricted for many reasons and includes a few high-level examples of restrictions. • How to overcome possible restrictions. • The effects when it is not possible to overcome restrictions to access people and information. Specifically, the implications of management-imposed restriction for auditor's evaluation of management integrity. <p>The Task Force has also included additional guidance material to specifically guide auditors with access restrictions related to equity-accounted investments.</p>
<p>The setting of materiality, and component materiality, and how the concept of aggregation risk affects materiality decisions.</p>	<p>The Task Force further discussed these issues and reaffirmed the views discussed with the IAASB in September 2019 that:</p> <ul style="list-style-type: none"> • The concept of aggregation risk should be further emphasized in ISA 600 (Revised); and • Additional guidance would be helpful regarding the factors that the auditor may consider in establishing component performance materiality, as well as the threshold to be used for communicating misstatements to the group engagement team. <p>Given the calls for greater clarity about the concept of aggregation risk, the Task Force concluded that it would be appropriate to include a definition in the revised standard. Accordingly, the Task Force added the definition (aggregation risk: the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the group financial statements as a whole) in ISA 600 (Revised). The Task Force also included additional application guidance which emphasises that while aggregation risk exists and needs to be addressed in all audits of financial statements, it is particularly important to understand and address in a group audit engagement. This is because aggregation risk increases as the</p>

	<p>number of components increases at which audit procedures are performed separately, either by component auditors or the group engagement team.</p> <p>The aggregation risk is addressed by setting an appropriate performance materiality (which is set a lower level than planning materiality for the financial statements as a whole to reduce the impact of aggregation risk). The extant ISA 600 includes reference to both component materiality and component performance materiality. The Task Force concluded that using both terms in a group audit context can be confusing as technically only component performance materiality is applicable (as the objective is not to form an opinion over the component's financial statements).</p> <p>Accordingly, the Task Force has changed 'component materiality' to 'component performance materiality' and revised the definition to recognize that this is an amount set by the group engagement team to reduce to an appropriately low level the aggregation risk resulting from the disaggregation of account balances, classes of transactions or disclosures across components for purposes of performing audit procedures.</p> <p>The Task Force has also added additional application material paragraphs to:</p> <ul style="list-style-type: none"> • Clarify that the component performance materiality cannot be greater than the group performance materiality. Similarly, the clearly trivial threshold set for a component cannot be greater than the clearly trivial threshold for the group. • Describe the factors the group engagement team may take into account in setting component performance materiality (e.g. the extent of disaggregation across components, and expectations about the nature, frequency and magnitude of misstatements in component financial information).
The role that the concept of financially significant component plays in the proposed group engagement led approach.	<p>Under the proposed risk-based approach, there is no longer a requirement to identify and audit significant components. This has resulted in some stakeholders' questioning whether sufficient work would be performed on matters such as, fraud, related parties, going concern and subsequent events under the risk-based approach. To address these concerns, the Task Force made several changes to the requirements and application material to clarify and strengthen the group engagement team's responsibility related to fraud, related parties, going concern and subsequent events.</p>
Communications and reporting between the component auditor and the group engagement team.	<p>The Task Force continues to hold the view that the group engagement team is responsible for the identification, assessment and responses to the risks of material misstatement. Component auditors may, depending on the facts and circumstances, be involved if they have a more in-depth knowledge of the components at which they perform audit procedures than the group engagement team is expected to have.</p> <p>The group engagement team needs to direct and supervise the work performed by component auditors and review their work. The nature, timing and extent of the direction and supervision, including two-way communication between the group engagement team and the</p>

	<p>component auditor, depends on the facts and circumstances of the engagement. The communication encompasses:</p> <ul style="list-style-type: none"> • Understanding the entity and its environment, the applicable financial reporting framework and the entity's system of internal control: the group engagement team, to the extent necessary, communicate with component auditors or component management to discuss about the business activities that may give rise to a risk of material misstatement of the group financial statements. • Identifying and assessing the risks of material misstatement: The group auditor communicates the assessed risks of material misstatement that are relevant to the work of the component auditor. • Responding to the assessed risks of material misstatement: When the group engagement team determines that component auditors need to be involved in performing the further audit procedures, the group engagement team determines how the component auditors will be involved and may request the component auditor to use one of the "traditional" three strategies, that is: <ul style="list-style-type: none"> a) An audit of all financial information of the component using component materiality. b) An audit of one or more account balances or classes of transactions of the financial information of a component, or information relevant to disclosures, relating to risks of material misstatement of the group financial statements. c) Specific further audit procedures relating to risks of material misstatement of the group financial statements.
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Material Presented

Agenda item 9.1

Agenda item 9.2

Board meeting summary paper

Draft ISA (NZ) 600 (Revised) (marked up changes to the version considered by the IAASB in its September 2019 meeting)