

March 31, 2004

Mr. Jim Sylph  
Technical Director  
International Federation of Accountants  
545 Fifth Avenue, 14th Floor  
New York, NY 10017

Dear Mr. Sylph,

We appreciate this opportunity to comment on the proposed revised International Standard on Auditing (ISA) 600, *The Work of Related Auditors and Other Auditors in the Audit of Group Financial Statements*, and the proposed International Auditing Practice Statement (IAPS), *The Audit of Group Financial Statements*. We believe the issuance of further policies and guidance in the area of group audits is critical and are strongly supportive of the development of this revised standard and new practice statement. However, we do have some recommendations for clarifying the proposed ISA 600 and IAPS, as described below.

We believe audits conducted under one quality control process and audit methodology best protect the public interest. By involving only one auditor<sup>1</sup>, communications will be improved and better consistency of audit procedures achieved. Accordingly, we believe there usually should be only one auditor (including related auditors) involved in an audit of group financial statements. Although we do not believe the auditing standards should mandate that one auditor perform the entire audit, we do believe those charged with governance and auditors should critically evaluate the reasons for having multiple auditors and whether using multiple auditors is consistent with appropriate audit effectiveness.

However, we do recognize that there are legitimate circumstances in which the use of only one auditor is not feasible, for example in the case of an acquisition or joint venture. In these situations, we strongly believe that the group auditor must perform more stringent, additional procedures than those currently proposed in the exposure drafts. If the procedures which we recommend throughout the remainder of this letter are *required* of the group auditor in a

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<sup>1</sup> The term “one auditor,” as used throughout this letter, is meant to include “related auditors” who operate under the same quality control system, using the same audit methodology. This is consistent with the strengthened definition of “related auditor” we recommend on the last page of this letter.

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“multiple auditor” approach, then we believe it would be appropriate for the group auditor to perform such procedures and assume full responsibility for the group audit.

Our recommendations are specifically described below.

**Better describe what work the group auditor should perform in order to take “full responsibility”**

The proposed standard and guidance provide much needed improvement in defining the requirements of the group auditor. We agree with the direction of these improvements but question whether they go far enough. To better serve the public interest and improve investor confidence in the capital markets, we strongly believe there needs to be a much clearer description of the work the group auditor should perform in order to take “full responsibility.”

Our main concern is that, in the proposed revised ISA 600, we believe the proposed requirements to be performed by the group auditor are not necessarily sufficient to take “full responsibility” for the group audit. Currently, when an audit is conducted by multiple auditors the public generally is not made aware that multiple auditors may have performed the audit yet, especially where auditors conducting an audit of a group do not have common methodologies and quality control processes, the assurance the group auditor has obtained may vary widely depending on the work they perform related to the parts of the group they do not audit directly.

Below is a scenario that illustrates our concern related to transparency of this issue to readers of the audit report.

Scenario

Company A and Company B are, for the purpose of this discussion, identical – they operate in the same industry, are the same size and have facilities in the same locations. Company A is audited directly by one auditor, auditor X. Company B is audited 55% by one auditor, auditor X, and 45% by another auditor, auditor Y – auditor X and auditor Y are in no way related. Auditor X takes full responsibility for both audit A and audit B.

Due to a lack of mandatory requirements in the proposed revised ISA 600, auditor X is not *required* to perform any direct procedures on the components which comprise the 45% of Company B audited by auditor Y. It is also possible in this situation that auditor X may not review *any* audit evidence from auditor Y. As currently written, proposed revised ISA 600 only *requires* the group auditor to consider items such as the professional qualifications and independence of the other auditor, communicate with and obtain written communications from the other auditor, and consider the findings of the other auditor. However, auditor X is still permitted to assume full responsibility for the audit of Company B.

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Therefore, when a user of the financial statements reads the audit reports for Company A and Company B as produced by auditor X, there is no difference between the two reports. However, the work effort required of the group auditor (auditor X) and the evidence to be obtained by the group auditor as mandated in the proposed revised ISA 600 is significantly different for both audits. Accordingly the level of assurance obtained in both audits is also significantly different.

The combined work of auditor X and auditor Y in audit B may be the same as the total work performed by auditor X alone in audit A. However, if auditor X does not perform sufficient procedures directly on Company B, auditor X is relying solely on communications with auditor Y as audit evidence. This is inherently riskier when X and Y are not related and do not have established lines of communication, similar audit methodologies and common quality control processes to rely on.

In order to be transparent to the public and readers of the audit report, we strongly believe that:

- (1) The audit reports in this scenario should be the same only when the level of assurance obtained in both situations (and, therefore, effectiveness of the audit and quality of the audit report) is the same.
- (2) If the level of assurance obtained by auditor X is not the same for both audits, it is in the public interest for the reader to be made aware in the audit report that more than one auditor participated in the group audit. For example, in the case of joint audits in France, readers are made aware in the audit report that multiple auditors were involved.

We strongly believe that the preferable approach is to require that “the level of assurance required to be obtained by the group auditor” in each of the two audits be equivalent. Accordingly, we believe that the proposed requirements in ISA 600 need to be strengthened. This can be accomplished mostly by bringing guidance from the proposed IAPS into ISA 600 and, as described below, creating additional specific requirements for the group auditor.

On a separate note, we also recommend that the IAASB consider issuing a practice statement on joint audits, to improve consistency in practice of this related issue, especially in situations where there are joint auditors of a parent company (i.e., the auditors are “jointly” the group auditor). There is guidance in French and Danish literature which may be useful as a starting point for developing the practice statement.

*Recommendation 1 – change the terminology from “sole responsibility” to “full responsibility”*

We believe that the word “full” should be used in both ISA 600 and the IAPS instead of “sole,” as this term better articulates the concept that the group auditor is taking responsibility for the work of others. The word “sole” can be defined as “having no sharer,” “being the only

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one,” “functioning independently and without assistance or interference,” all of which imply that other auditors were not involved at all, which surely is not the case in most circumstances when the group auditor takes “sole responsibility.” Accordingly, we recommend that the term be changed to “full responsibility.”

Recommendation 2 – set limitations on “Acceptance and Continuance” of the group auditor:

We believe that a group auditor should not accept or continue an engagement to take “full responsibility” for the group financial statements if the group auditor and related auditors do not directly perform a significant amount of the work on the group financial statements. There is a risk that an entity specifically decides to employ multiple auditors in a scheme to “divide and conquer” – essentially to conceal information about the “big picture” from any single auditor. Accordingly, we believe that some of the guidance on “Acceptance and Continuance” which is currently in the IAPS should be revised and moved to ISA 600, as follows:

***The group auditor should not accept an engagement to audit group financial statements where the group auditor and related auditor directly perform work on less than a significant portion of the group assets, liabilities, cash flows, profit or turnover (derived from paragraph 12 of IAPS).***

***A significant portion ordinarily is approximately 60% of the group assets, liabilities, cash flows, profit or turnover, but may vary in different circumstances. It is important to understand the reasons why an entity is choosing to engage multiple auditors, and the auditor uses professional judgment in deciding whether to accept or continue as group auditor in situations when the auditor is asked to audit less than 60%.***

***Additionally, there may be circumstances where the group auditor is put in a situation where the group auditor temporarily has less than 60% of the group assets, liabilities, cash flows, profit or turnover of the group financial statements. For example, because of an acquisition made during the middle of the year, the percentage of assets audited directly by the group auditor may change from 65% to 50%. In such circumstances, when it is impractical for the auditor to quickly react to the situation (by either resigning as group auditor or being engaged to directly audit additional components), the group auditor may still continue to serve as group auditor for the current year. However, the group auditor attempts to increase the percentage of the group financial statement audited as soon as possible, or ordinarily does not accept the engagement for the following year.***

***The group auditor should not accept an engagement where components that have been identified at the group level as likely to include significant risks of material misstatement of the group financial statements are audited by other auditors, unless the group auditor will be able to participate in the work***

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***performed by the other auditor's on the component's financial information*** (derived from paragraph 13 of IAPS). Note: "participate in the work performed by the other auditor" is described in Recommendation 3.

***The group auditor considers the practicality of participating in the other auditor's work. For example, in the case of a component operating in a foreign jurisdiction, or in the case of a tight timetable for completing the audit, the group auditor may not be able to perform some or all of the procedures described in paragraph 9 of this proposed ISA that the group auditor considers necessary. Where the group auditor is unable to participate in the work of the other auditor to the extent considered necessary, the group auditor should not accept the engagement*** (derived from paragraph 15 of IAPS).

*Recommendation 3 – require procedures to be performed by the group auditor on the "riskier components":*

If there are components that are of individual significance or components that have been identified at the group level as likely to include significant risks of material misstatements of the group financial statements, which are not directly audited by the group auditor or related auditors, we strongly believe that the group auditor should be required to perform some procedures on those components. We are supportive of the guidance which is current in the IAPS on this subject, and believe it should be moved into ISA 600 and be made bold lettered requirements. We believe that the inclusion of this in ISA 600 will appropriately raise the level of work required in order to take full responsibility of a group audit. Accordingly, we recommend including the following in ISA 600:

***For components that are of individual financial significance or components that have been identified at the group level as likely to include significant risks of material misstatement of the group financial statements, the group auditor should:***

- ***Direct inquiries to component management and the other auditors*** (paragraph 34 of IAPS).
- ***Obtain an understanding of the components*** (paragraph 38 of IAPS).
- ***Hold discussions with other auditors or key members of their teams on the susceptibility of an entity to material misstatements of the financial statements due to fraud*** (paragraphs 45 and 46 of IAPS).
- ***Participate in the other auditor's risk assessment*** (paragraph 46 of IAPS).
- ***Perform some further audit procedures*** (derived from paragraph 62 of IAPS).
- ***Review the other auditor's working papers*** (paragraph 62 of IAPS).
- ***Perform procedures designed to identify subsequent events at those components*** (paragraph 78 of IAPS).

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*Recommendation 4 – beyond the “riskier components,” require some procedures performed by the group auditor on the work of the other auditor:*

Recommendation 3 discussed procedures that we believe should be performed on the “riskier components” which are not directly audited by the group auditor or related auditors. In addition to these required procedures on the “riskier components,” we believe that the group auditor should perform some procedures on components, which when aggregated with other individually insignificant components, may be of financial significance or give rise to significant risks of material misstatement of the group financial statements.

For such components that are not directly audited by the group auditor or related auditors, in order for the group auditor to obtain sufficient appropriate audit evidence to take “full responsibility” for the group audit, we recommend that the group auditor **should**:

- Obtain the other auditor’s evaluation of misstatements.
- Obtain and read the other auditor’s report.
- Use professional judgment to consider performing one or more of the following (*Note - see Recommendation 5 on the use of professional judgment*):
  - Meet with component management.
  - Perform planning and risk assessment procedures. These may be performed jointly with the other auditor, or directly by the group auditor.
  - Perform further audit procedures. These may be performed jointly with the other auditor, or directly by the group auditor.
  - Participate in the other auditor’s evaluation of audit evidence.
  - Participate in the closing and other key meetings between the other auditor and component management.
  - Review the other auditor’s working papers.

*Recommendation 5 – in the ISA, provide guidance on interpreting the extent of involvement of the group auditor:*

As currently stated in the proposed ISA 600 and IAPS, we agree with the statement that professional judgment should be exercised by the group auditor to determine the group auditor’s extent of involvement in the other auditor’s work. However, in considering which of the items in Recommendation 4 should be performed by the group auditor on work performed directly by the other auditor, the group auditor should consider the guidance in paragraph 64 of the proposed IAPS, which we believe should be moved into the proposed ISA 600:

***The greater the individual financial significance of the component or the significance of the risks of material misstatement, or the lower the level of the group auditor’s satisfaction with the professional qualifications, professional competence, and resources of the other auditor, or of the quality control process of the other***

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*auditor's firm, the greater is the group auditor's participation in the other auditor's work.*

**Better define the "related auditor"**

*Recommendation 6 – strengthen the definition of "related auditor"*

Our suggestions above are based on the principle that the group auditor *and* the related auditor should directly perform a significant portion of the work on the group financial statements in order to take "full responsibility." However, we believe that the current definition of "related auditor" should be strengthened, to further convey the thought that simply sharing the same firm name does not, in and of itself, make auditors "related."

Also, we believe that the reference to ISQC 1 in the definition could be interpreted to mean, provided that two different firms both comply with ISQC 1, that they are "related," even though they may have *differing* policies and procedures, which both comply. The definition should be based on the fact that the policies and procedures are the same, not that they comply with an international standard.

Accordingly, we suggest the following revisions to the definition of related auditor in ISA 600 and the IAPS (*additions shown in bold underline and deletions shown in strikethrough*):

"Related auditor" means an independent auditor from the group auditor's office, other office of the group auditor's firm, a network firm or another firm **that:**

- ~~operating~~**es** under common quality control policies and procedures, **and** as described in International Standard on Quality Control (ISQC 1), "Quality Control for Audit, Assurance and Related Services Practices."
- **uses the same audit methodology.**

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We appreciate the opportunity to comment, and would be pleased to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact P. Nicholas Fraser at (212) 492-4118

Very truly yours,

/s/ Deloitte Touche Tohmatsu