ADVANCED AUDIT AND ASSURANCE

CORPORATE LEVEL

TUTE 13

Special Considerations – Audit of Group Financial Statements.

(S.L.Au.S - 600)

by

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Introduction

The group auditor should gain an understanding of the group as a whole and assess risks for the group as a whole and for individually significant components.

The group auditor has to ensure other auditors are professionally qualified, meet quality control and ethical requirements and will allow the group auditor access to working papers or components themselves.

The group engagement partner is responsible for the direction, supervision and performance of the group audit.

As the Auditor of the Group Financial Statements, the Auditor has to decide followings

A) To determine whether to act as the auditor of the Group Financial Statements.
B) If acting as the auditor of the group financial statements

    1) To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings

    2) To obtain sufficient appropriate audit evidence about the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework

Definitions

Component. - An entity or business activity for which the group or component management prepares financial information that should be included in the group financial statements.

Component auditor. - An auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit,

Component materiality- The materiality level for a component determined by the group engagement team.

Group. - All the components whose financial information is included in the group financial statements. A group always has more than one component.

Group financial statements may include amounts derived from financial statements which have not been audited by the group auditors, but by a different firm altogether: the component auditor. Components of group financial statements can include subsidiaries, associates, joint ventures and branches.

Important Point

- ***The group auditor takes sole responsibility for the group audit opinion.***

- ***The group engagement partner is responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and applicable legal and regulatory requirements, and whether the auditor's report that is issued is appropriate in the circumstances.***

- ***If the opinion on a component is qualified, the group audit opinion is only affected if the matter is material to the group. Only a matter which is material in a group context will affect the group audit opinion.***

How to decide whether it is a significant component or not

What is Significant Component?

A component identified by the group engagement team:

(a) that is of individual significance to the group, or

(b) that due to its specific nature or circumstances, is likely to include significant risks of material misstatement of the group financial statements.

As per the standard a significant component can be identified by using a benchmark. **If component assets, liabilities, cash flows, profit or turnover (whichever is the most appropriate benchmark) exceed 15% of the related group figure, then the auditor may judge that the component is a significant component.**

If a component is financially significant to the group financial statements then the group engagement team or a **component auditor will perform a full audit based on the component materiality level.**

Components that are not 'significant components' will be subject to Analytical Procedures at a group level - a full audit is not required

Planning and Risk Assessment

A) **Obtaining an Understanding of the Group, its components and their environment.**
Eg: The Group Structure,
Components Business Activities
A description of Group wide Controls
Complexity of the Consolidation Process

B) **Understanding the Component Auditors**

S.L.Au.S 600 requires the group engagement team to obtain an understanding of the component auditor. This involves an assessment of the following.

- Whether the component auditor is ***Independent*** and understands and will comply with the ethical requirements that are relevant to the group audit
- The component auditor's ***professional competence***
- Whether the group engagement team will be **involved in the work of the component auditor** to the extent that it is necessary to obtain sufficient appropriate audit evidence
- Whether the component auditor operates in a ***regulatory environment*** that actively oversees auditors

C) **Materiality**

The group auditor is responsible for setting the materiality level for the group financial statements as a whole. Materiality levels should also be set for components which are individually significant. These should be set at a lower level than the materiality level of the group as a whole. The Component Materiality shall be lower than the Materiality for the Group Financial Statements as s whole.

D) **Involvement in the work of a Component Auditor**

The extent of involvement by the group auditor at the planning stage will depend on the:

- Significance of the component
- Risks of material misstatement of the group financial statements
- Extent of the group auditor's understanding of the component auditor

The basic rule is that where the component is significant, the group auditor must be involved in the component auditor's work.

The group auditor may perform the following procedures.

1. **Meeting** with the **component management or the component auditors** to obtain an understanding of the component and its environment

2. Reviewing the component auditor's **overall audit strategy and audit plan**
3. **Performing risk assessment procedures** to identify and assess risks of **material misstatement at the component level**. These may be performed with the component auditor or by the group auditor.
4. Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error.
5. Reviewing the Component Auditors Documentation of identified significant risk of material misstatement.

Evaluation the Work of the Component Auditor

For all companies in the group, the group auditor is required to perform a review of the work done by the component auditor. This is normally achieved by reviewing a report or questionnaire completed by the component auditor which highlights the key issues which have been identified during the course of the audit.

The effect of any uncorrected misstatements and any instances where there has been an inability to obtain sufficient appropriate audit evidence should also be evaluated. On the basis of this review the group auditor then needs to determine whether any additional procedures are necessary. These may include:

- Designing and performing further audit procedures. These may be designed and performed with the component auditors, or by the group auditor.
- Participating in the closing and other key meetings between the component auditors and component management
- Reviewing other relevant parts of the component auditors' documentation In co-operating with the group auditor the component auditor would be expected to provide access to audit documentation unless prohibited from doing so by law.

Audit Procedures for Consolidation Process

Step 01	Compare the audited financial statements of each subsidiary/associate the consolidation schedules to ensure figures have been transposed correctly, and that all components have been included.
Step 02	Review the adjustments made on consolidation to ensure they are appropriate and comparable with the previous year. This will involve
	• Recording the dates and costs of acquisitions of subsidiaries and the assets acquired • Calculating goodwill and pre-acquisition reserves arising on consolidation • Preparing an overall reconciliation of movements on reserves and non-controlling interests • Reconciling any inter-company balances, and eliminating intra-group items from profit or loss

	- Verifying that where relevant, subsidiary balances have been included in the group accounts at fair value, eg properties, which may be carried at depreciated cost in the subsidiary, must be at fair value in the group accounts - Verifying that the deferred tax consequences of consolidation and fair value adjustments have been accounted for correctly
Step 03	For business combinations determine
	- Whether the combination has been appropriately treated as an acquisition - The appropriateness of the date used as the date of combination - The treatment of the results of investments acquired during the year - If acquisition accounting has been used, that the fair value of acquired assets and liabilities is reasonable (to ascertainable market value by use of an expert) - Goodwill has been calculated correctly and reviewed annually for indicators of impairment
Step 04	For Disposals
	- Agree the date used as the date for disposal to sales documentation - Review management accounts to ascertain whether the results of the investment have been included up to the date of disposal, and whether figures used are reasonable
Step 05	Consider whether previous treatment of existing subsidiaries or associates is still correct (consider level of influence, degree of support),
Step 06	Verify the arithmetical accuracy of the consolidation workings by recalculating them.
Step 07	Review the consolidated financial statements for compliance with the legislation, accounting standards and other relevant regulations. - Group companies do not have coterminous accounting periods - Accounting policies of group members differ because foreign subsidiaries operate under different rules - Treatment of participating interests and associates - Treatment of goodwill and intangible assets - Taxation - Foreign currency translation - Treatment of loss-making subsidiaries
Step 08	Review the consolidated financial statements to confirm that they give a true and fair view in the circumstances.