Audits of Less Complex Entities – Part 10, Audits of Group Financial Statements

This agenda item presents drafting of requirements relating to group audits that may be included in the proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE). This drafting contains requirements and Essential Explanatory Material (EEM) that were identified for inclusion through the evaluation of requirements in ISA 600 (Revised)1 presented at Agenda Item 5-C.

This drafting does not yet contain EEM identified through a review of the application material included in ISA 600 (Revised) or otherwise deemed necessary for inclusion to support the requirements.

Paragraph numbers highlighted in grey refer to the paragraph number in ISA 600 (Revised), as presented in Agenda Item 5-C. Tracked changes are shown from the paragraph in ISA 600 (Revised) presented excluding footnotes and references to application material.

Contents highlighted in yellow relates to the use of component auditors and would not be included if the Board decides not to include component auditors in the scope of the standard.

## 10. Audits of Group Financial Statements

**Content of this Part**

Part 10 sets out the special considerations that apply to an audit of group financial statements.

**Scope of this Part**

(Para. 1) The International Standards on Auditing (ISAs) apply. This Part applies to an audit of group financial statements (a group audit). (Para. 2) Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph 14(k) of ISA for LCE. The term consolidation process as used in ISA for LCE refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions.

(Para. 4) A group may be organized in various ways. For example, a group may be organized by legal or other entities (e.g., a parent and one or more subsidiaries, joint ventures, or investments accounted for by the equity method). Alternatively, the group may be organized by geography, by other economic units (including branches or divisions), or by functions or business activities. In ISA for LCE, these different forms of organization are collectively referred to as “entities or business units.”

(Para. 11) The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this Part. The term “the group engagement partner shall take responsibility for...” or “the group auditor shall take responsibility for...” is used for those requirements when the group engagement partner or group auditor, respectively, is permitted to assign the design or

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1 International Standard on Auditing (ISA) 600 (Revised), Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)
performance of procedures, tasks or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. For other requirements, this ISA expressly intends that the requirement or responsibility be fulfilled by the group engagement partner or group auditor, as applicable, and the group engagement partner or group auditor may obtain information from the firm or other members of the engagement team.

(Para. 1 cont.) This ISA—Part deals with special considerations that apply to a group audit, including in those circumstances when component auditors are involved. The requirements and guidance in this Part ISA refer to, or expand on the application of other parts of the ISA for LCE relevant ISAs to a group audit, in particular ISA 220 (Revised), ISA 230, ISA 300, ISA 315 (Revised 2019), and ISA 330.

(Para. 3) As explained in ISA 220 (Revised), this ISA—Part, adapted as necessary in the circumstances, may also be useful in an audit of financial statements other than a group audit when the engagement team includes individuals from another firm. For example, this ISA—Part may be useful when involving such an individual to attend a physical inventory count, inspect property, plant and equipment, or perform audit procedures at a shared service center at a remote location.

10.1 Objectives

10.1.1. (Para. 13) The objectives of the auditor are to:

(a) With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained to provide a basis for forming an opinion on the group financial statements;

(b) Identify and assess the risks of material misstatement of the group financial statements, whether due to fraud or error, and plan and perform further audit procedures to appropriately respond to those assessed risks; and

(eb) Be sufficiently and appropriately involved in the work of component auditors throughout the group audit, including communicating clearly about the scope and timing of their work, and evaluating the results of that work; and

(d) Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, as a basis for forming an opinion on the group financial statements.

10.2 Planning Activities

10.2.1 (Para. 22) In applying Part 5, ISA 300, the group auditor shall establish, and update as necessary, an overall group audit strategy and group audit plan—the scope, timing and direction of the group audit. In doing so, the group auditor shall determine:

(a) The components at which audit work will be performed; and

(b) The resources needed to perform the group audit engagement including the nature, timing and extent to which component auditors are to be involved.
The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, the group auditor uses professional judgment in determining the components at which audit work will be performed. This determination is based on the group auditor’s understanding of the group and its environment, and other factors such as the ability to perform audit procedures centrally, the presence of shared service centers, or the existence of common information systems and internal control.

The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this Part ISA. Component auditors may have greater experience with, and a more in-depth knowledge of, the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit.

ISA 220 (Revised) Part 3 requires the engagement partner to determine that sufficient and appropriate resources to perform the engagement are assigned or made available to the engagement team in a timely manner. In a group audit, such resources may include component auditors. Therefore, this ISA requires the group auditor to determine the nature, timing and extent of involvement of component auditors.

Paragraphs 10.7.1–10.7.11. include requirements when the group auditor involves component auditors.

10.3 Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group’s System of Internal Control

10.3.1. In applying ISA 315 (Revised 2019), the group auditor shall take responsibility for obtaining an understanding of the following:

(a) The group and its environment, including:
   (i) The group’s organizational structure and its business model, and system of internal control, including: consolidation process and consolidation adjustments.
      a. The locations in which the group has its operations or activities;
      b. The nature of the group’s operations or activities and the extent to which they are similar across the group; and
      c. The extent to which the group’s business model integrates the use of information technology (IT).
   (ii) Regulatory factors impacting the entities and business units in the group; and
   (iii) The measures used internally and externally to assess the financial performance of the entities or business units;

3 Part 3, Engagement Quality Management, paragraph 3.2.7
4 Part 6, Risk Identification and Assessment, Section 6.3
(b) The applicable financial reporting framework and the consistency of accounting policies and practices across the group; and

(c) The group’s system of internal control, including:

   (i) The nature and extent of commonality of controls;

   (ii) Whether, and if so, how, the group centralizes activities relevant to financial reporting;

   (iii) The consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments; and

   (iv) How group management communicates significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group's system of internal control to management of entities or business units.

10.4 Identifying and Assessing the Risks of Material Misstatement

10.4.1. (Para. 33) In applying ISA 315 (Revised 2019), Part 6, based on the understanding obtained in paragraph 30.10.3.1, the group auditor shall take responsibility for the identification and assessment of the risks of material misstatement of the group financial statements, including with respect to the consolidation process.

10.5 Materiality

10.5.1. (Para. 35) In applying ISA 320Part 5 and ISA 450Part 7, when classes of transactions, account balances or disclosures in the group financial statements are disaggregated across components, for purposes of planning and performing audit procedures, the group auditor shall determine:

   (a) Component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality.

   (b) The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor. Such threshold shall not exceed the amount regarded as clearly trivial to the group financial statements.

10.6 Responding to the Assessed Risks of Material Misstatement

10.6.1. (Para. 37) In applying ISA 330Part 7, the group auditor shall take responsibility for the nature, timing and extent of further audit procedures to be performed, including determining the components at which to perform further audit procedures and the nature, timing and extent of the work to be performed at those components.

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5 Part 6, Risk Identification and Assessment, Section 6.4.
6 Part 5, Planning, paragraph 5.3.3.
7 Part 7, Responding to Assessed Risks of Material Misstatement, paragraph 7.5.1.
8 Part 7, Responding to Assessed Risks of Material Misstatement, paragraphs 7.3.1–7.3.2.
Consolidation Process

10.6.2. **(Para. 38)** The group auditor shall take responsibility for designing and performing further audit procedures to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This shall include:

(a) Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub-consolidations;

(b) Evaluating the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications;

(c) Evaluating whether management’s judgments made in the consolidation process give rise to indicators of possible management bias; and

(d) Responding to assessed risks of material misstatement due to fraud arising from the consolidation process.

10.7 Considerations When Using Component Auditors

**(Para. 8)** Audit risk is a function of the risks of material misstatement and detection risk. Detection risk in a group audit includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this ISA for LCE requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this ISA for LCE explains the matters that the group auditor takes into account when determining the nature, timing and extent of the direction and supervision of component auditors and the review of their work.

Planning Activities

10.7.1. **In establishing the scope, timing and direction of the audit, the group auditor shall:**

(a) **(Para. 23)** In establishing the overall group audit strategy and group audit plan, the group engagement partner shall evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor.

(b) **(Para. 24)** As part of the evaluation in paragraph 23, the group auditor shall request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor.

10.7.2. **(Para. 25)** In applying ISA 220 (Revised), Part 3,\(^9\) the group engagement partner shall take responsibility for:

(a) Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and

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\(^9\) Preface-ISA for LCE, EEM after paragraph P.11.
\(^{10}\) Part 3, Engagement Quality Management, paragraph 3.2.5.
(b) Confirming whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.

10.7.3. *(Para. 27)* The group auditor shall obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor if:

(a) The component auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement; or

(b) The group engagement partner has serious concerns about the competence and capabilities of the component auditors or matters in paragraphs 23–26 10.7.1. and 10.7.2.

### Identifying and Assessing the Risks of Material Misstatement

10.7.4. *(Para. 34)* In applying ISA 315 *(Revised 2019) - Part 6* the group auditor shall evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements.

### Evaluating the Component Auditor's Communications and the Adequacy of Component Auditor’s Work

10.7.5. *(Para. 47)* The group auditor shall determine whether, and the extent to which, it is necessary to review additional component auditor audit documentation. In making this determination, the group auditor shall consider:

(a) The nature, timing and extent of the work performed by the component auditor;

(b) The competence and capabilities of the component auditor as determined in accordance with paragraph 26(a); and

(c) The direction and supervision of the component auditor and review of their work.

10.7.6. *(Para. 48)* If the group auditor concludes that the work of the component auditor is not adequate for the group auditor’s purposes, the group auditor shall determine what additional audit procedures are to be performed, and whether they are to be performed by a component auditor or by the group auditor.

### Auditor’s Report

10.7.7. *(Para. 53)* The auditor’s report on the group financial statements shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor’s report shall indicate that the reference does not diminish the group engagement partner’s or the group engagement partner’s firm’s responsibility for the group audit opinion.
### Communication with Component Auditors

10.7.8. The group auditor shall communicate with component auditors the matters below:

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<th>Topic</th>
<th>Matter to be Communicated</th>
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<td><strong>10.7.8.A.</strong> Planning Activities</td>
<td><em>(Para. 29)</em> The group auditor shall communicate with component auditor’s about their respective responsibilities and the group auditor’s expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit.</td>
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| **10.7.8.B.** Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group’s System of Internal Control | *(Para. 31)* The group auditor shall communicate to component auditors on a timely basis:  
(a) Matters that the group auditor determines to be relevant to the component auditor’s design or performance of risk assessment procedures for purposes of the group audit;  
(b) In applying ISA 550, related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor; and  
(c) In applying ISA 570 (Revised) Events or conditions identified by group management or the group auditor that may cast significant doubt on the group’s ability to continue as a going concern that are relevant to the work of the component auditor. |
| **10.7.8.C.** Materiality | *(Para. 36)* The group auditor shall communicate to the component auditor the amounts determined in accordance with paragraph 10.5.135. |
| **10.7.8.D.** Responding to the Assessed Risks of Material Misstatement | *(Para. 41)* When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor shall communicate with the component auditor about matters that the group auditor or component auditor determine to be relevant to the design of responses to the assessed risks of material misstatement of the group financial statements. |
### 10.7.9. The group auditor shall request component auditors to communicate to the group auditor:

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| **10.7.9.A.** Planning Activities | *(Para. 32)* The group auditor shall request component auditors to communicate on a timely basis:

- (a) Matters related to the financial information of the component that the component auditor determines to be relevant to the identification and assessment of the risks of material misstatement of the group financial statements, whether due to fraud or error;

- (b) Related party relationships not previously identified by group management or the group auditor; and

- (c) Any events or conditions identified by the component auditor that may cast significant doubt on the group’s ability to continue as a going concern. |

| **10.7.9.B.** Evaluating the Component Auditor’s Communications and the Adequacy of Their Work | *(Para. 45)* The group auditor shall request the component auditor to communicate matters relevant to the group auditor’s conclusion with regard to the group audit. Such communication shall include:

- (a) Identification of the financial information on which the component auditor has been requested to perform audit procedures;

- (b) Whether the component auditor has performed the work requested by the group auditor;

- (c) Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement;

- (d) Information about instances of non-compliance with laws or regulations;

- (e) Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph 10.7.8.C.36;

- (f) Indicators of possible management bias;

- (g) Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed;

- (h) Fraud or suspected fraud involving component management, employees who have significant roles in the group’s system of |
## Topic

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<td>internal control at the component or others where the fraud resulted in a material misstatement of the component financial information;</td>
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<td>(i) Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component;</td>
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<td>(j) Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in the written representations that the component auditor requested from component management; and</td>
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<td>(k) The component auditor’s overall findings or conclusions.</td>
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### 10.7.9.C. Subsequent Events

| **(Para. 50)** The group auditor shall request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements, if they become aware of such events. |

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**Responding to the Assessed Risks of Material Misstatement**

10.7.10. **(Para. 44)** The group auditor shall determine whether the financial information identified in the component auditor’s communication (see paragraph 45) is the financial information that is incorporated in the group financial statements.

**Evaluating the Component Auditor’s Communications and the Adequacy of Their Work**

10.7.11. **(Para. 46)** The group auditor shall:

- (a) Discuss significant matters arising from communications with the component auditor, including those in accordance with paragraph 45, with the component auditor, component management or group management, as appropriate; and
- (b) Evaluate whether communications with the component auditor are adequate for the group auditor’s purposes. If such communications are not adequate for the group auditor’s purposes, the group auditor shall consider the implications for the group audit.
10.8. Specific Communication Requirements

**Communication with Group Management and Those Charged with Governance**

10.8.1. The group auditor shall communicate with the appropriate level of management, or those charged with governance:

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<th>Matter to be Communicated</th>
<th>Group Management</th>
<th>Those Charged with Governance (where applicable)</th>
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<td><strong>10.8.1A</strong> <em>(Para. 55)</em> If fraud has been identified by the group auditor or brought to its attention by a component auditor <em>(see paragraph 45(h)),</em> or information indicates that a fraud may exist, the group auditor shall communicate this on a timely basis to the appropriate level of group management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities.</td>
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| **10.8.1B** *(Para. 57)* The group auditor shall communicate the following matters with those charged with governance of the group, in addition to those required by ISA 260 (Revised) and other ISAs:  
(a) An overview of the work to be performed at the components of the group and the nature of the group auditor’s planned involvement in the work to be performed by component auditors.  
(b) Instances when the group auditor’s review of the work of a component auditor gave rise to a concern about the quality of that component auditor’s work, and how the group auditor addressed the concern.  
(c) Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information.  
(d) Fraud or suspected fraud involving group management, component management, employees who have significant roles in the group’s system of internal control or others when the fraud resulted in a | ✓ | |

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10.9. Specific Documentation Requirements

10.9.1. **(Para. 59)** In addition to the general documentation requirements (Part 2.5.) for an audit engagement, in accordance with ISA 230, the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the nature, timing and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying ISA 230, the group auditor shall include in the audit documentation:

(a) Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed.

(b) The basis for the group auditor’s determination of components for purposes of planning and performing the group audit.

(c) The basis for the determination of component performance materiality, and the threshold for communicating misstatements in the component financial information to the group auditor.

(d) The basis for the group auditor’s determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components.

(e) Key elements of the understanding of the group’s system of internal control in accordance with paragraph 30(c);

(f) The nature, timing and extent of the group auditor’s direction and supervision of component auditors and the review of their work, including, as applicable, the group auditor’s review of additional component auditor audit documentation in accordance with paragraph 47.

(g) Matters related to communications with component auditors, including:

(i) Matters, if any, related to fraud, related parties or going concern communicated in accordance with paragraph 32.

(ii) Matters relevant to the group auditor’s conclusion with regard to the group audit, in accordance with paragraph 45, including how the group auditor has addressed significant matters discussed with component auditors, component management or group management.

(h) The group auditor’s evaluation of, and response to, findings or conclusions of the component auditors about matters that could have a material effect on the group financial statements.