

Proposed Explanatory Memorandum – Audit of Group Financial Statements

Background

Several bodies have asked for guidance on the audit of group financial statements, including the European Commission, the International Organization of Securities Commissions, the former Panel on Audit Effectiveness in the United States, and the International Forum on Accountancy Development. Accordingly, the predecessor of the International Auditing and Assurance Standards Board (IAASB), the International Auditing Practices Committee commenced a project on the audit of group financial statements. The IAASB aimed to establish standards and guidance on matters relevant to the audit of group financial statements that were not covered in existing International Standards on Auditing (ISAs), and to provide guidance on the application of existing ISAs to audits of group financial statements. The IAASB agreed that this would best be achieved by revising the existing ISA 600, “Using the Work of Another Auditor,” and developing a new International Auditing Practice Statement (IAPS) on “The Audit of Group Financial Statements.” The proposed revised ISA 600 deals with both “sole responsibility” and “division of responsibility.” The proposed IAPS applies when the group auditor takes sole responsibility for the auditor’s report on the group financial statements.

Significant Proposals

CHANGING THE FOCUS OF ISA 600

The existing ISA 600 requires that, when group financial statements include financial information of components that are audited by other auditors, the group auditor should (i.e. has to) determine how the work of the other auditors will affect the audit of the group financial statements. The revised ISA 600 reflects the IAASB’s belief that the decision as to whether to request a related auditor or other auditor to perform work on a component’s financial information is made later in the audit process, i.e. after the group auditor has conducted the group risk assessment, categorized the components based on the results of the group risk assessment and determined the scope of work to be performed on the components’ financial information.

The title of the revised ISA 600 reflects the wider scope of the revised ISA and its relevance to an audit of group financial statements.

CONTINUANCE AND ACCEPTANCE

To assist a group auditor in deciding whether to accept or continue an engagement to audit group financial statements, the related standards and guidance have been expanded in the revised ISA 600, and additional guidance has been included in the IAPS. The guidance provide for the group auditor to obtain a preliminary understanding of the group at the acceptance and continuance stage, and to consider the group auditor’s ability to participate appropriately in the work of other auditors should the group auditor conclude that his or her involvement, including the involvement of related auditors, is insufficient to accept or continue the engagement.

ACCESS TO INFORMATION

Access to information is dealt with in the revised ISA 600, which states that any restriction on the group auditor’s access to component information, component management or the related or other

auditors, including their working papers, is a scope limitation and that the group auditor should consider the impact thereof on the auditor's report on the group financial statements.

THE OTHER AUDITOR'S QUALITY CONTROL PROCESS

In addition to the other auditor's professional qualifications, independence, professional competence and resources, the group auditor is also required to consider the other auditor's quality control process. (Also see "Terminology" below.)

SOLE RESPONSIBILITY

The revised ISA 600 makes it clear that, in the case of "sole responsibility," the group auditor is responsible for determining the scope of work to be performed directly, or by related auditors or other auditors, on the components' financial information and on the consolidation to respond to the assessed risks of material misstatement of the group financial statements. In scoping the work to be performed on the components' financial information, the group auditor considers whether to participate in the work of related auditors or other auditors. The group auditor also determines the adequacy of the work of related auditors and other auditors for the group auditor's purposes. Standards and guidance on communication between the group auditor and related auditors or other auditors facilitates this process and documentation provides evidence thereof.

DIVISION OF RESPONSIBILITY

After extensive deliberation of the matter the IAASB agreed that, due to practical implementation issues and in the interest of convergence of national standards with international standards, "division of responsibility" should be retained as an alternative approach to "sole responsibility."

The group auditor is permitted to apply the approach if national standards enable and national law or regulation permits a reference to the other auditor in the auditor's report on the group financial statements. If the group auditor decides to follow this approach, he or she should follow the relevant national standards and national law or regulation, as well as the relevant requirements in the revised ISA 600.

PROPOSED IAPS

The IAPS provides guidance on the application of the proposed ISA 600 and other ISAs to the audit of group financial statements. The guidance follows the new audit risk model reflected in the recently issued Audit Risk Standards of the IAASB.

The group auditor obtains an understanding of the group and its environment, including group-wide controls, and of the consolidation, sufficient to identify the risks associated with the consolidation and the presentation of the financial statements, and to categorize the components as follows: (a) components that are of individual financial significance; (b) components that are likely to include significant risks of material misstatement of the group financial statements; (c) components that when aggregated with other such components represent a level of financial significance that could cause the group financial statements to be materially misstated; and (d) components that are not of individual financial significance and, even when aggregated with other such components, do not give rise to risks of material misstatement of the group financial statements. The group auditor determines the scope of work to be performed on the components' financial information accordingly. The scope of work may be an audit based on materiality determined in the context of the component's financial information, an audit based on materiality determined by the group auditor for the component, or specified limited scope engagements.

The guidance on materiality is limited and will be reconsidered when the Materiality Task Force has completed its revision of ISA 320, “Audit Materiality.”

TERMINOLOGY

In the existing ISA 600, related auditors are a subset of other auditors. However, in the revised ISA 600 it is dealt with separately, recognizing that in the case of a related auditor the group auditor ordinarily will be able to rely on common policies and procedures on recruitment, training, advancement, auditor independence, audit methodology and quality control.

Commentators Guide and Consideration of Specific Issues

The IAASB welcomes comments on the revised ISA 600 and the IAPS. In responding to the proposed pronouncements, commentators are requested to refer to the specific pronouncement and the relevant paragraphs within the pronouncements. The responses should include the reasons for the comments, including specific suggestions for any proposed changes to wording.

The IAASB is seeking comments on all matters addressed in the exposure drafts. In addition, the IAASB is interested in comments on its decision to retain the “division of responsibility approach” as an alternative to “sole responsibility” in certain specified circumstances.

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