

## PROPOSED ADDITIONS TO THE AUTHORITY FOR GROUP AUDITS

Marked from Exposure Draft of Proposed Part 10, Audits of Group Financial Statements of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE).

### A. Authority of the ISA for Audits of Financial Statements of Less Complex Entities

#### Limitations for Using the ISA for LCE

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#### *Specific Prohibitions*

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A.1. The ISA for LCE shall not be used if:

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- (d) The audit is an audit of group financial statements (group audit) and:
  - (i) Any of the group's individual entities or business units meet the criteria as described in paragraph A.1.(b) or A.1.(c); or
  - (ii) Component auditors are involved, except when the component auditor's involvement is limited to circumstances in which a physical presence is needed for a specific audit procedure for the group audit (e.g., attending a physical inventory count or inspecting physical assets, [documents](#), or [records](#)).

*A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a store with multiple branches. When those business units have characteristics such as separate locations, separate management, separate general ledger and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.*

*In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this ISA for LCE.*

**Component Auditors**

A component auditor is an auditor who performs audit work related to a component<sup>1</sup> for purposes of the group audit. A component auditor is a part of the engagement team for a group audit. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor’s firm (e.g., another office within the group auditor’s firm).

In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

Part 3 contains requirements in relation to engagement quality, including relevant ethical requirements, and the direction and supervision of the members of the engagement team, and the review of their work.

~~When the auditor responsible for the group audit performs audit procedures related to a component, the auditor is not considered a component auditor.~~

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**Qualitative Characteristics**

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- A.3. The following list describes characteristics of a typical LCE for the purpose of determining the appropriate use of the ISA for LCE. The list is not exhaustive nor intended to be absolute, and other relevant matters may also need to be considered. Numerical indicators have been provided as illustrative examples to describe a typical LCE and are not intended to be definitive. Each of the qualitative characteristics may on its own not be sufficient to determine whether the ISA for LCE is appropriate or not in the circumstances. Therefore, the matters described in the list are intended to be considered both individually and in combination. For the purpose of group audits, these considerations shall apply to both the group and each of its individual entities and business units.

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<p>Business Activities, Business Model &amp; Industry</p>	<p>The entity’s business activities, business model or the industry in which the entity operates do not give rise to significant pervasive business risks.</p> <p>There are no specific laws or regulations that govern the business activities that add complexity (e.g., prudential requirements).</p> <p>The entity’s transactions result from few lines of business or revenue streams.</p>
<p>Organizational Structure and Size</p>	<p>The organizational structure is relatively straightforward, with few reporting lines or levels and a small key management team (e.g., 5 individuals or less).</p>

<sup>1</sup> A component is an entity, business unit, function or business activity, or some combination thereof, determined by the group auditor responsible for the group audit for the purposes of planning and performing audit procedures in a group audit.

Ownership Structure	The entity’s ownership structure is straightforward and there is clear transparency of ownership and control, such that all individual owners and beneficial owners are known.
Nature of Finance Function	The entity has a centralized finance function, including centralized activities related to financial reporting.  There are few employees involved in financial reporting roles (e.g., 5 individuals or less).
Information Technology (IT)	The IT environment of the entity, including its IT applications and IT processes, is straightforward.  The entity uses commercial software and does not have the ability to make any program changes other than to configure the software (e.g., the chart of accounts, reporting parameters or thresholds).  Access to the software is generally limited to one or two designated individuals for the purpose of making the configurations.  Few formalized general IT controls are needed in the entity's circumstances.
Application of the Financial Reporting Framework and Accounting Estimates	Few accounts or disclosures in the financial statements of the entity necessitate the use of significant management judgment in applying the requirements of the financial reporting framework.  The entity’s financial statements ordinarily do not include accounting estimates that involve the use of complex methods or models, assumptions or data.

Additional Characteristics Relevant for Group Audits

*For group audits, the following qualitative characteristics are to be considered in addition to those above:*

Group Structure and Activities	The group has few entities or business units (e.g., 5 or less).  Group entities or business units are limited to <u>few jurisdictions with similar characteristics, such as laws and regulations, business practices, language and culture, or where jurisdictions operate in a common economic zone. (e.g., 3 or less).</u>
Access to Information or People	Group management will be able to provide the engagement team with access to information and unrestricted access to persons within the group as determined necessary by the <u>group</u> auditor.

Consolidation Process	<p>The group has a simple consolidation process. For example:</p> <ul style="list-style-type: none"><li>• Financial information of all entities or business units has been prepared in accordance with the <u>same-similar</u> accounting policies applied to the group financial statements;</li><li>• All entities or business units have the same financial reporting period-end as that used for group financial reporting;</li><li>• <del>There are no sub-consolidations; and</del></li><li>• Intercompany, or other consolidation adjustments are not complex.</li></ul>
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*Notwithstanding that professional judgment is applied in determining whether this standard is appropriate to use, if there is uncertainty about whether an audit meets the criteria as set out in this Authority, the use of the ISA for LCE is not appropriate.*

## PROPOSED PART 10 – AUDITS OF GROUP FINANCIAL STATEMENTS

Marked from Exposure Draft of Proposed Part 10, *Audits of Group Financial Statements*, of the Proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE).

### 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. [Throughout this Part “the auditor” should be read as the “group auditor”.](#)

#### *Scope of this Part*

All parts of the ISA for LCE apply to an audit of group financial statements (a group audit). The requirements and guidance in this Part refer to, or expand on, the application of other parts of the ISA for LCE to a group audit.

#### 10.1. Objective

10.1.1. The objective of the auditor is to 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.

#### 10.2. Planning Activities

10.2.1. In applying Part 5, the auditor shall establish, and update as necessary, the scope, timing and direction of the group audit. In doing so, the auditor shall determine:

- (a) The components at which audit work will be performed; and
- (b) The resources needed to perform the group audit engagement.

#### *Components*

*The determination of components at which to perform audit work is a matter of professional judgment. Matters that may influence the auditor’s determination include, for example:*

- *The nature of events or conditions that may give rise to risks of material misstatement at the assertion level of the group financial statements that are associated with a component, for example, newly formed or acquired entities or business units or entities or business units in which significant changes have taken place.*
- *The disaggregation of significant classes of transactions, account balances and disclosures in the group financial statements across components, considering the size and nature of assets, liabilities and transactions at the location or business unit relative to the group financial statements.*

- *Whether sufficient appropriate audit evidence is expected to be obtained for all significant classes of transactions, account balances and disclosures in the group financial statements from audit work planned on the financial information of identified components.*
- *The nature and extent of misstatements or control deficiencies identified at a component in prior period audits.*
- *The nature and extent of the commonality of controls across the group and whether, and if so, how, the group centralizes activities relevant to financial reporting.*

*Based on the understanding of the group's organizational structure and information system, the auditor may determine that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the auditor may decide to treat these three legal entities as one component.*

#### *Resources*

*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. The auditor's determination of the resources needed to perform the group audit are a matter of professional judgment and may include the understanding of the group, the components within the group at which audit work is to be performed, the location of such components and any related jurisdictional factors such as language, culture and regulation, and whether to perform work centrally, at components or a combination thereof.*

- 10.2.2. If, after the acceptance or continuance of the group audit engagement, the engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the engagement partner shall consider the possible effects on the group audit.

### **10.3. Materiality**

- 10.3.1. In applying Part 5, 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 auditor shall determine component performance materiality. To address aggregation risk, such amount shall be lower than group performance materiality.

*The component performance materiality amount may be different for each component. Also, the component performance materiality amount for an individual component need not be an arithmetical portion of the group performance materiality and, consequently, the aggregate of component performance materiality amounts may exceed group performance materiality.*

*The ISA for LCE does not require component performance materiality to be determined for each class of transactions, account balance or disclosure for components at which audit procedures are performed. However, if, in the specific circumstances of the group, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial statements, Part*

5 requires a determination of the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures. In these circumstances, the auditor may need to consider whether a component performance materiality lower than the amount may be appropriate for those particular classes of transactions, account balances or disclosures.

The determination of component performance materiality is not a simple mechanical calculation and involves the exercise of professional judgment. Factors the auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (e.g., as the extent of disaggregation across components increases, a lower component performance materiality ordinarily would be appropriate to address aggregation risk). The relative significance of the component to the group may affect the extent of disaggregation (e.g., if a single component represents a large portion of the group, there likely may be less disaggregation across components).
- Expectations about the nature, frequency, and magnitude of misstatements in the component financial information, for example the nature and extent of misstatements identified at the component in prior audits.

To address aggregation risk, paragraph 10.3.1. requires component performance materiality to be lower than group performance materiality. In some circumstances, however, component performance materiality may be set at an amount closer to group performance materiality because there is less aggregation risk, such as when the financial information for one component represents a substantial portion of the group financial statements.

#### 10.4. Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group's System of Internal Control

10.4.1. In applying Part 6, the auditor shall obtain an understanding of:

- (a) The group's organizational structure and business model, including the locations in which the group has its operations or activities and the extent to which the operations and IT systems are similar across the group.

(aA) The applicable financial reporting framework and the consistency of accounting policies and practices across the group.

- (b) The group's system of internal control, including:

(i) The consolidation process used by the group and consolidation adjustments;

(ii) The nature and extent of commonality of controls;~~;- and~~

(iii) How the group centralizes activities relevant to financial reporting; and

(iv)- How group management communicates significant matters that support the preparation of the group financial statements to management of entities or business units.

## 10.5. Identifying and Assessing the Risks of Material Misstatement

10.5.1. In applying Part 6, based on the understanding obtained in paragraph 10.4.1. the auditor shall identify and assess the risks of material misstatement of the group financial statements, including with respect to the consolidation process.

*In applying Part 6, the auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud, and to design and perform further audit procedures whose nature, timing and extent are responsive to the assessed risks of material misstatement due to fraud at the assertion level. Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:*

- *Whether there are particular components that are more susceptible to risks of material misstatement due to fraud.*
- *Whether any fraud risk factors or indicators of management bias exist in the consolidation process.*
- *How those charged with governance of the group monitor group management's processes for identifying and responding to the risks of fraud in the group, and the controls group management has established to mitigate these risks.*
- *Responses of those charged with governance of the group, and group management to the auditor's inquiry about whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.*

## 10.6. Responding to the Assessed Risks of Material Misstatement

10.6.1. In applying Part 7, the auditor shall determine the components at which to perform further audit procedures and the nature, timing and extent of the work to be performed at those components.

*Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally.*

*The auditor may determine that the financial information of components can be considered as a single population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogeneous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way. In such cases, group performance materiality often will be used for purposes of performing these procedures.*

*In other circumstances, procedures to respond to the risks of material misstatement of the group financial statements that are related to the financial information of a component may be more effectively performed at the component level.* In responding to the assessed risks of material misstatement, the auditor may determine the following scope of work to be appropriate at a component:

- *Design and perform further audit procedures on the entire financial information of the component;*

- *Design and perform further audit procedures on one or more classes of transactions, account balances or disclosures; or*
- *Perform specific further audit procedures.*

*Further audit procedures may be designed and performed centrally if the audit evidence to be obtained from performing further audit procedures on one or more significant classes of transactions, account balances or disclosures in the aggregate will respond to the assessed risks of material misstatement, for example, if the accounting records for the revenue transactions of the entire group are maintained centrally.*

*The auditor may determine that the financial information of components can be considered as a single population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogeneous because they share the same characteristics, the related risks of material misstatement are the same, and controls are designed and operating in a consistent way. In such cases, group performance materiality often will be used for purposes of performing these procedures.*

### Consolidation Process

10.6.2. The auditor shall design and perform 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;
- (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.

*The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements that do not pass through the usual IT applications, and may not be subject to the same controls to which other financial information is subject. The auditor's evaluation of the appropriateness, completeness and accuracy of the adjustments and reclassifications may include:*

- *Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;*
- *Determining whether those entities or business units whose financial information has been included in the group financial statements were appropriately included;*
- *Determining whether significant adjustments have been correctly calculated, processed and authorized by group management and, when applicable, by component management;*
- *Determining whether significant adjustments are properly supported and sufficiently documented; and*

- *Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits, and intra-group account balances.*

## 10.7. Specific Communication Requirements

Communication with ~~Group Management and~~ Those Charged with Governance of the Group

~~10.7.1. If fraud has been identified by the auditor, or information indicates that a fraud may exist, the 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.~~

10.7.2. The auditor shall communicate the following matters with those charged with governance:

- (a) An overview of the work to be performed at the components of the group.
- (b) 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 material misstatement of the group financial statements.

## 10.8. Specific Documentation Requirements

10.8.1. In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the auditor shall include in the audit documentation:

- (a) The basis for the auditor's determination of components for purposes of planning and performing the group audit.
- (b) The basis for the determination of component performance materiality.
- (c) Key elements of the understanding of the group's system of internal control.

# PROPOSED CONFORMING AMENDMENTS ARISING FROM PROPOSED PART 10, AUDITS OF GROUP FINANCIAL STATEMENTS

Marked from Exposure Draft of the ISA for LCE

## Preface ISA for LCE

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### Format of the [Draft] ISA for LCE

P.12. The [draft] ISA for LCE includes:

- The Authority (Part A), which sets out the circumstances for which the [draft] ISA for LCE is prohibited or not appropriate to use.
- Part 1, which sets out the fundamental concepts and overarching principles to be applied throughout the audit.
- Part 2, which sets out the general requirements for audit evidence and documentation, as well as the overall objective of the audit.
- Part 3, which sets out the auditor's and engagement partner's obligations and responsibilities for quality management in an audit of an LCE.
- Parts 4 to 9, which follow the flow of an audit engagement, and set out the detailed requirements for the audit. Each of these Parts also includes specific communication and documentation requirements as necessary.
- Part 10, which sets out special considerations that apply to an audit of group financial statements (a group audit). When the ISA for LCE applies to a group audit, the requirements and guidance in Part 10 refer to, or expand on the application of other relevant parts of the ISA for LCE to a group audit.
- Appendices, which include the glossary of terms used in this [draft] standard, assertions, an illustrative engagement letter and an illustrative representation letter, as well as other relevant supporting materials for implementation of the requirements within this [draft] standard.

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## Part 9. Forming an Opinion and Reporting

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### 9.4. Auditor's Report

9.4.1. The auditor shall report in accordance with the specified format and content below unless:

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## **INDEPENDENT AUDITOR’S REPORT**

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### **Auditor’s Responsibilities for the Audit of the Financial Statements<sup>1 2</sup>**

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## **Glossary of Terms**

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**Aggregation risk**—The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statement as a whole.

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**Component**—An entity, business unit, function or business activity, or some combination thereof, determined by the auditor for purposes of planning and performing audit procedures in a group audit.

**Component auditor**— An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team for a group audit.

**Component management**—Management responsible for a component.

**Component performance materiality**—An amount set by the auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.

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**Group**—A reporting entity for which group financial statements are prepared.

**Group audit**— The audit of group financial statements.

**Group auditor**—The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for:

- (a) Establishing the overall group audit strategy and group audit plan;
- (b) Directing and supervising component auditors and reviewing their work;

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<sup>1</sup> When the auditor disclaims an opinion on the financial statements, the description of the auditor’s responsibilities only includes the matters required by paragraph 9.5.4.

<sup>2</sup> When Part 10 applies, further describe the auditor’s responsibilities in a group audit engagement by stating that:

- (i) The auditor’s responsibilities are to plan and perform the group audit to obtain sufficient appropriate audit evidence regarding the financial information of the entities or business units within the group as a basis for forming an opinion on the group financial statements;
- (ii) The auditor is responsible for the direction, supervision and review of the audit work performed for purposes of the group audit; and
- (iii) The auditor remains solely responsible for the auditor’s opinion.

~~(a)~~(c) Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements.

**Group financial statements**—Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of the ISA for LCE, a consolidation process includes:

- (a) Consolidation, proportionate consolidation, or an equity method of accounting;
- (b) The presentation in combined financial statements of the financial information of entities or business units that have no parent but are under common control or common management; or
- (c) The aggregation of the financial information of entities or business units such as branches or divisions.

**Group management**—Management responsible for the preparation of the group financial statements.

**Group performance materiality**— Performance materiality in relation to the group financial statements as a whole, as determined by the auditor.