

**Please note: This is an IAASB LCE Agenda Paper that will be discussed by the Board at the September 2022 IAASB quarterly meeting (Agenda Item 5-D).**

### 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)<sup>1</sup> 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)** 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. The term consolidation process as used in the 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 the 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.

<sup>1</sup> International Standard on Auditing (ISA) 600 (Revised), *Special Considerations-Audits of Group Financial Statements (Including the Work of Component Auditors)*



*(Para. 1 cont.,)* This 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 refer to, or expand on the application of other parts of the ISA for LCE relevant to a group audit.

*(Para. 3)* This 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 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 remote location.

## 10.1 Objectives

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

- (a) 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
- (b) 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.

## 10.2 Planning Activities

10.2.1 *(Para. 22)* In applying Part 5,<sup>2</sup> the group auditor shall establish, and update as necessary, 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.

*(Para. 5) 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 or the existence of common information systems and internal control.*

*(Para. 7) The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this Part.*

*(Para. 6)* Part 3<sup>3</sup> 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.

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

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<sup>2</sup> Part 5, *Planning*, Section 5.2

<sup>3</sup> Part 3, *Engagement Quality Management*, paragraph 3.2.7



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

10.3.1. (Para. 30) In applying Part 6,<sup>4</sup> the group auditor shall take responsibility for obtaining an understanding of the group's organizational structure, business model, and system of internal control, including consolidation process and consolidation adjustments.

### 10.4 Identifying and Assessing the Risks of Material Misstatement

10.4.1. (Para. 33) In applying Part 6<sup>5</sup>, based on the understanding obtained in paragraph 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 Part 5<sup>6</sup> and Part 7<sup>7</sup>, 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 Part 7<sup>8</sup>, 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.

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

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<sup>4</sup> Part 6, *Risk Identification and Assessment*, Section 6.3.

<sup>5</sup> Part 6, *Risk Identification and Assessment*, Section 6.4.

<sup>6</sup> Part 5, *Planning*, paragraph 5.3.3.

<sup>7</sup> Part 7, *Responding to Assessed Risks of Material Misstatement*, paragraph 7.5.1.

<sup>8</sup> Part 7, *Responding to Assessed Risks of Material Misstatement*, paragraphs 7.3.1–7.3.2.



- (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.<sup>9</sup> 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, the 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, the 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)* Evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor.
- (b) *(Para. 24)* 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 Part 3,<sup>10</sup> 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
- (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;<sup>11</sup> or
- (b) The group engagement partner has serious concerns about the competence and capabilities of the component auditors or matters in paragraphs 10.7.1. and 10.7.2.

<sup>9</sup> Preface-ISA for LCE, EEM after paragraph P.11.

<sup>10</sup> Part 3, *Engagement Quality Management*, paragraph 3.2.5.

<sup>11</sup> Part 1, *Fundamental Concepts, General Principles and Overarching Requirements*, paragraph 1.2.1.



### *Identifying and Assessing the Risks of Material Misstatement*

10.7.4. (Para. 34) In applying Part 6<sup>12</sup> 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 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; 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.

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<sup>12</sup> Part 6, *Risk Identification and Assessment*, paragraph 6.5.9.



**Communication with Component Auditors**

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

	Topic	Matter to be Communicated
10.7.8.A.	Planning Activities	(Para. 29) 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.
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) 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) 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) 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 amounts determined in accordance with paragraph 10.5.1.
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, 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:

	Topic	Matter to be Communicated
10.7.9.A.	Planning Activities	<p>(Para. 32) On a timely basis:</p> <ul style="list-style-type: none"> <li>(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;</li> <li>(b) Related party relationships not previously identified by group management or the group auditor; and</li> <li>(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.</li> </ul>
10.7.9.B.	Evaluating the Component Auditor's Communications and the Adequacy of Their Work	<p>(Para. 45) Matters relevant to the group auditor's conclusion with regard to the group audit including:</p> <ul style="list-style-type: none"> <li>(a) Identification of the financial information on which the component auditor has been requested to perform audit procedures;</li> <li>(b) Whether the component auditor has performed the work requested by the group auditor;</li> <li>(c) Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement;</li> <li>(d) Information about instances of non-compliance with laws or regulations;</li> <li>(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.;</li> <li>(f) Indicators of possible management bias;</li> <li>(g) Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed;</li> <li>(h) Fraud or suspected fraud involving component management, employees who have significant roles in the group's system of internal control at the component or others where the fraud resulted in a material misstatement of the component financial information;</li> </ul>



	Topic	Matter to be Communicated
		<p>(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; and</p> <p>(k) The component auditor's overall findings or conclusions.</p>
10.7.9.C.	Subsequent Events	(Para. 50) Subsequent events that may require adjustment of, or disclosure in, the group financial statements, if they become aware of such events.

*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 10.7.9.B.(a)) is the financial information that is incorporated in the group financial statements.

*Evaluating the Component Auditor's Communications*

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

- (a) Discuss significant matters arising from communications with the component auditor, 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:

	Matter to be Communicated	Group Management	Those Charged with Governance (where applicable)
10.8.1A	(Para. 55) If fraud has been identified by the group auditor or brought to its attention by a component auditor, 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.	✓	
10.8.1B	<p>(Para. 57) The following matters:</p> <p>(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.</p> <p>(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.</p> <p>(c) 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.</p>		✓

## 10.9. Specific Documentation Requirements

10.9.1. (Para. 59) In addition to the general documentation requirements (Part 2.5.) for an audit engagement, the group auditor shall include in the audit documentation:



- (a) The basis for the group auditor's determination of components for purposes of planning and performing the group audit.
- (b) The basis for the determination of component performance materiality, and the threshold for communicating misstatements in the component financial information to the group auditor.
- (c) The basis for the group auditor's determination that component auditors have the appropriate competence and capabilities.
- (d) 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 .
- (e) Matters related to communications with component auditors, including how the group auditor has addressed significant matters discussed with component auditors, component management or group management.
- (f) 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.