

DEFINITION of TRANSNATIONAL AUDIT

This guidance statement, issued by the Transnational Auditors Committee (TAC), is designed to provide guidance to assist members of the Forum of Firms (FoF) in meeting their membership obligations.

**Per the
Constitution:**

Transnational audit means an audit of financial statements which are or may be relied upon outside the audited entity's home jurisdiction for purposes of significant lending, investment or regulatory decisions; this will include audits of all financial statements of companies with listed equity or debt and other public interest entities which attract particular public attention because of their size, products or services provided.

TAC Guidance:

Audits of entities with listed equity or debt are always transnational audits as their financial statements are or *may* be relied upon outside their home jurisdiction. Even where an entity currently has no foreign shareholders there is a possibility that the financial statements may be relied on by a foreign investor or creditor at some future date in an actual or potential investment or lending decision and it is therefore appropriate to consider the audit as a transnational audit.

Other audits that are transnational audits shall include audits of those entities in either the public or the private sectors where there is a reasonable expectation that the financial statements of the entity *may* be relied upon by a user outside the entity's home jurisdiction for purposes of significant lending, investment or regulatory decisions, whether or not the entity has listed equity or debt *or* where entities attract particular attention because of their size, products or services provided. Significant in this context does not include the use of financial statements to establish normal trade terms with vendors or to open accounts with financial institutions (i.e. accounts for purposes of collecting customer receipts or making vendor payments). For the avoidance of doubt, the audit of an office required solely for the purpose of legal formation or continuing legal existence in a particular jurisdiction does not constitute a transnational audit.

The types of entities for which the audit might be considered transnational because of their size or the nature of the products and services they provide include, for example, large charitable organizations or trusts, major monopolies or duopolies, providers of financial or other borrowing facilities to commercial or private customers, deposit-taking organizations and those holding funds belonging to third parties in connection with investment or savings activities.

The definition of a transnational audit should be applied to the whole group audit, as defined in ISA 600, including all the components whose financial information is included in the group financial statements. The audit of an individual component of a group could, however, be a transnational audit without the group audit being transnational if the component qualifies under the criteria.

Audits of foreign subsidiaries may be transnational audits even where the audit is primarily performed to comply with national regulations in the foreign country. However, foreign subsidiaries may not be classified as transnational if they are insignificant particularly where the parent company audit is not classified as transnational or if the audit of the parent company is not classified as transnational and the audit of the subsidiary would not be classified as a transnational audit if it were not for the ownership structure alone.

Audits of government owned entities would not fall within the definition “transnational audit” unless their financial statements are or may be relied upon outside the home jurisdiction or they “attract particular attention because of their size, products or services provided”. However, the audits of many large government-owned entities would fall within the definition of “transnational audit” because of foreign borrowings. The fact that the audit of a government owned entity is classified as a transnational audit under either of the two criteria, does not mean that the audits of other entities owned by the same government automatically become transnational; each entity needs to be considered separately against the criteria.

Audits of banks and other financial institutions. The audits of credit institutions receiving deposits or other repayable funds from the public or granting credits as part of a banking activity or entities carrying on life or non-life insurance or reinsurance activities and other similar institutions would normally be considered as transnational audits because of their size or the nature of the products and services they provide, particularly if they involve cross-border activities. Exceptions to this would occur where it can be clearly demonstrated that the entities do not “attract particular attention because of their size, products or services provided” and there is no significant transnational element from the perspective of an actual or potential financial statement user. Potential transnational users would include investors, lenders, other financial institutions, governments and regulators.

Relationship with the IFAC Code of Ethics

The IFAC Code of Ethics (applicable January 1, 2011) contains the following definition of a public interest entity and related guidance:

Public interest entities are listed entities plus entities defined by regulation or legislation as a public interest entity or for which the audit is required to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. The Code encourages firms and member bodies to determine whether to treat other entities as public interest entities because the entities have a large number and wide range of stakeholders. The factors to be considered include the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders; size; and number of employees.

Defining an audit as a transnational audit requires a member to perform the audit using “policies and methodologies that are based, to the extent practicable, on ISAs and which conform to the IFAC Code for Professional Accountants”. The provisions of the IFAC Code relevant to “public interest entities” will apply to a transnational audit if that audit is also defined as a “public interest entity” audit under the provisions of the IFAC Code. Although many transnational audits will also be defined as “public interest audits” there will be others which will not be so defined.

Examples:

1. The audit of a private company in U.S. raising debt finance in Canada

This would qualify as a transnational audit as it is reasonable to expect that the financial statements of the company would be used across national borders in obtaining the debt financing.

2. The audit of a private Venezuela-based brokerage firm that makes investments in the U.S. on behalf of its Venezuelan clients

To determine whether the financial statements are or may be relied upon outside of Venezuela, one would consider whether there were any U.S. regulatory (e.g., NASD) requirements as well as consider the location of any investors in and lenders to the brokerage. If financial statements are filed with a U.S. regulator or there are investors or lenders outside of Venezuela, this would qualify as a transnational audit. Even if the brokerage audit does not qualify as transnational because of these factors, it is also necessary to assess whether the audit of the brokerage qualifies as transnational because of its size or the products or services provided. To do this further facts are necessary.

3. The audit of a private savings and loan business operating entirely in the U.S. (i.e., only U.S. depositors and U.S. investments)

This would not qualify as a transnational audit assuming it can be demonstrated that there are no actual or possible transnational users. Given the nature of the business, it is also unlikely to qualify on the basis of its size or the products or services provided.

4. The audit of a national charity taking donations in the country where it is domiciled and making grants around the world

It is not immediately clear as to whether there is any reliance on the financial statements by users outside of the country where the charity is based. Consideration should be given to whether the financial statements are being used outside of the country where the charity is based for purposes of significant lending, investment or regulatory decisions in which case this would qualify as a transnational audit. It is also necessary to consider whether the audit qualifies as transnational because of the size or the nature of the products or services provided; if the charity is a large one the audit could qualify.

5. The audit of an international charity taking donations through various national branches and making grants around the world

This entity is clearly operating across borders. Further, the international structure would create a reasonable expectation that the financial statements could be used outside the charity's home jurisdiction by donors or others for purposes of significant lending, investment or regulatory decisions and accordingly the charity's audit is likely to qualify as transnational.

6. The audit of a private internet betting company registered in BVI, which operates from Costa Rica and takes wagers by credit card on a worldwide basis via the internet

Assuming there is no restriction on gamblers, it clearly operates across borders but it is unlikely that the gamblers would place any reliance on the financial statements. However, other possible users, such as governments or regulators in foreign countries, could place reliance on the statements and the audit would then be classified as a transnational audit; further facts are needed. Unless the entity is large enough to pass the size test, it is unlikely that the audit would qualify as transnational under the second criterion as internet gambling would probably not come within the "nature of products or services" definition.

7. The audit of an internet stockbroker restricted by local securities laws to trading with local residents and on local exchanges

It does not trade across national borders and if it can be demonstrated that there are no transnational users, the audit would be not classified as a transnational audit unless the stockbroker was large enough to qualify

under the size criterion; given the restrictions on trading and investing this is unlikely and therefore the broker's audit would not be a transnational audit.

8. The audit of the project financial statements for the construction of an electrical generation facility in Nigeria using funds loaned by the World Bank

As it can be clearly demonstrated that the financial statements are being used outside of the country where the facility is based for purposes of significant lending, investment or regulatory decisions, the audit would be considered a transnational audit.

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