

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

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 and application material in ISA 600 (Revised).¹

This agenda is tracked from the version presented at the September 2022 Board Meeting except for the EEM. Newly added EEM paragraphs are not shown as an addition. EEM that was included in the version provided in September 2022 and since removed is tracked as a deletion.

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

All parts of the ISA for LCE This Part applies 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.

~~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.~~

~~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.”~~

~~The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this Part.~~

~~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.~~

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

~~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. The objectives of the auditor ~~is~~are 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 ~~;~~and

~~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. In applying Part 5,² 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.

~~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.~~

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.*
- *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.*

²—Part 5, *Planning*, Section 5.2

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.

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

Part 3~~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.

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

10.3. Materiality [Previously Section 10.5.]

10.3.1. In applying Part 5⁴ and Part 7⁵, 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) c~~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.*~~

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:

³—Part 3, *Engagement Quality Management*, paragraph 3.2.7

⁴—Part 5, *Planning*, paragraph 5.3.3.

⁶—Part 7, *Responding to Assessed Risks of Material Misstatement*, paragraph 7.5.1.

- *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 10.35.1 requires component performance materiality to be lower than group performance materiality. As the extent of disaggregation across components increases, a lower component performance materiality amount ordinarily would be appropriate to address aggregation risk. 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 [Previously Section 10.3.]

10.4.1. In applying Part 6,⁶ the ~~group~~ auditor shall ~~take responsibility for~~ obtaining an understanding of:

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

10.5. Identifying and Assessing the Risks of Material Misstatement [Previously Section 10.4.]

10.5.1. In applying Part 6⁷, based on the understanding obtained in paragraph 10.43.1, 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.

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:

⁶—Part 6, *Risk Identification and Assessment*, Section 6.3.

⁷—Part 6, *Risk Identification and Assessment*, Section 6.4.

- *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 7⁸, 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.

In response 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 ~~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:

⁸ ~~Part 7, Responding to Assessed Risks of Material Misstatement, paragraphs 7.3.1–7.3.2.~~

- (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 Considerations When Using Component Auditors [This section has been deleted based on the Board's decision to prohibit the use of component auditors in the ISA for LCE]

10.7. Specific Communication Requirements [Previously Section 10.8.]

Communication with Group Management and Those Charged with Governance

10.7.1. ~~The group auditor shall communicate with the appropriate level of management, or those charged with governance.~~ 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. [Previously paragraph 10.8.1A.]

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

- (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.~~

(be) 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. [Previously paragraph 10.8.1B.]

	Matter to be Communicated	Group Management	Those Charged with Governance (where applicable)
10.8.1A	[Moved to paragraph 10.7.1.]	✓	
10.8.1B	[Moved to paragraph 10.7.2.]		✓

10.8. Specific Documentation Requirements [Previously Section 10.9.]

10.8.1. 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.~~