Article: An approach to examination questions on the auditing of group financial statements

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Candidates at the Professional Two examination stage are, no doubt, quite familiar with tacking questions on the Financial Reporting aspects of consolidated or group financial statements. They may, however, be less familiar with this topic from the perspective of the paper "Audit Practice & Assurance Services". However, it is the case that in many ways the same type of approach will serve candidates well in the Auditing paper as in the Advanced Corporate Reporting paper. This article explores in a little more detail the best way to approach questions about the auditing of group financial statements.

The matter is dealt with in the recently revised ISA 600 "*Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*" which was prepared by the International Auditing and Assurance Standards Board (IAASB). The terminology on this topic has been set out in this Standard.

Terminology

The audit firm responsible for the audit opinion on the consolidated financial statements is referred to as the "Group Auditor". If there are any parts of the group audited by any other firms of auditors these auditors are referred to as "Component Auditors". Typically a component would be a subsidiary but could also be a division, a joint venture, a branch, or some other part of the group. Almost invariably, the auditors of the parent company will also be the auditors of the consolidated financial statements but remember these are two distinct roles. For example, a parent company could have an unmodified Audit Report but there could be a modification of the Audit Report of the group Financial Statements.

An approach to examination questions on group audits

The following are the steps that candidates may wish to follow if presented with a group auditing scenario:

1. Establish the group structure. In this regard pay particular attention to the following:

    a. How many companies are in the group – are they all subsidiaries or are some of them, for example, associated companies?
    b. If they are subsidiaries, are they wholly owned i.e. Does the issue of non-controlling interests (or minority interests as they used to be called) arise?
    c. Does the parent company and all of its subsidiaries have the same year-end date or are some adjustments required in this respect?
    d. Are there more than one firm of auditors involved? If so, the group auditors may rely on the work of the component auditors only after they have satisfied themselves that the work is sufficient and appropriate in terms of the evidence gathered. This is often established by the issue of a "Reporting Pack" containing relevant details from the component auditors to the group auditors. There should not really be a problem in this regard if the other firm are

“Registered Auditors” in Ireland or the UK but otherwise certain differences in practice could arise.

  e. Have any of the components received anything other than a standard unmodified report? If so, the group auditor needs to consider the impact on the group audit report. This issue comes down to materiality. In the context of the group financial statements an issue that is material to a component may be immaterial so it does not follow that a modification in a component’s Audit Report will inevitably lead to a modified group Audit Report.

2. Consider how intra-group transactions have been dealt with. These should be cancelled in the consolidation process; however, the search for intra-group transactions may give rise to issues in relation to Related Party Transactions (IAS 24; ISA 550).

3. When completing this exercise candidates should pay particular attention to dates. Some components may have been acquired, for example, after the period end. This generally constitutes a Non Adjusting Event after the Reporting Period (Post Balance Sheet Events as they more commonly called) under IAS 10. These events are referred to as Subsequent Events in the relevant Auditing Standard - ISA 560.

4. Next, candidates should examine the position in each individual component. Examination questions will often give certain details about something that has happened in a particular component. These vignettes are often stand-alone pieces of information that require the candidate to recognise that some particular action is required in relation to a specific component or a particular risk that exists in some component. Examples of these issue could include:

   a. Information about a fraud perpetrated in a particular component.
   b. The existence of a condition in a component which could give rise to the need. for a provision or a contingent liability under IAS 37.
   c. The existence of evidence of asset impairments under IAS 36.
   d. The existence of components with modified Audit Reports.
   e. Components with Going Concern issues.

   It is worth emphasising again that an issue that is material to a particular component may not be material to the Group as a whole.

5. Finally, remember (as referred to previously) that the audit of the Group Financial Statements is different to the audit of the Parent Company Financial Statements.

Auditing the consolidation adjustments

Next, we turn our attention to the steps necessary to carry out audit procedures on the consolidation adjustments. These are as follows:

1. Check the transposition of the Financial Statements of each subsidiary to the consolidation schedule.

2. Review and check the consolidation adjustments. Some of these are “permanent adjustments” such as the calculation of goodwill on consolidation; others are annual adjustments such as the calculation of the figure for Non-Controlling Interests. The audit of Goodwill brings in the issue of Fair Value Accounting and ISA 540 *Auditing*

Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures is relevant here.

3. Ensure that intra-group items have been properly eliminated.

4. Review the Reporting Pack which should have been received from the component auditor.

5. Check the tots on the consolidation schedule.

Joint Audits

Joint audits are often referred to in the context of the audit of Group Financial Statements but technically they are not the same and they are not covered by ISA 600. Indeed, they are not covered by any International Standard on Auditing.

A Joint Audit refers to a situation in which two or more firms of auditors are jointly responsible for the audit of the Financial Statements of an entity. In this case, an Engagement Partner from both firms would usually sign the Audit Report. This might arise in a situation where two entities had come together but a group in the technical sense had not come into being. Joint Audits are rare. They usually happen in a situation where a business sees some particular advantage in engaging the expertise or local knowledge of a local firm but wants to be seen to have the status of a national or international firm. It may also be the case that local management want to continue a relationship with a firm they know well and whom they feel offer them good value.

The two main disadvantages of joint audits are:

1. It is difficult to co-ordinate the work of both firms so as to avoid duplication or worse, omissions in the audit process.

2. Both firm are (at least theoretically) jointly and severally liable for each others’ work and so many firms are reluctant to enter into this type of arrangement.