

## CHAPTER 2

# Audit of group financial statements

### This article aims to:

Summarise key changes and considerations involved with an audit of group's financial statements.



## Introduction

ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the work of component auditors)* is an extension and revised version of ISA 600. The standard applies to an audit of group's financial statements (a group audit) and brings out special considerations that apply to a group audit, including in those circumstances when component auditors are involved.

ISA 600 (Revised) includes new and revised requirements and application material that aligns the standard with recently revised standards such as ISQM 1, *Quality Management For Firms That Perform Audits Or Reviews Of Financial Statements, Or Other Assurance Or Related Services Engagements*; ISA 220 (Revised), *Quality Management For An Audit Of Financial Statements* and ISA 315 (Revised 2019), *Identifying And Assessing The Risks Of Material Misstatement*. A group audit poses various challenges for an auditor specifically when group auditors are required to work with other component auditor(s).

The revised standard provides a new 'risk-based approach' to planning and conducting group audits. This approach will help drive greater focus by the group engagement team on their responsibility to identify and assess the risks of material misstatement of the group financial statements and to design and perform further audit procedures to respond to those risks, in order to obtain sufficient appropriate audit evidence in respect of the group audit as a whole. This is a fundamental responsibility of the group auditor and the standard places an increased emphasis on it.

The revised standard defines 'group' and 'component' and clarifies the applicability of the standard to wide range of group structures that exist e.g. shared service centers, entities with branches and divisions and non-controlled entities, including equity accounted investees and investments carried at cost.

The revised standard is effective for audits of group financial statements for periods beginning on or after 15 December 2023.



## What's new

Some of the new requirements of ISA 600 are as follows:

- **Communication between group and the component auditor:** ISA 600 in its revised form reinforces the need for robust communication during the audit. The standard has been strengthened and clarified on the need for two-way communications between the group auditor and component auditors. These communications would include communication of relevant ethical requirements, determination of competence and capabilities of the component auditor, and determination of the appropriate nature, timing and extent of involvement by the group auditor in the work of the component auditor. The standard highlights group auditor's expectation that communications will take place at appropriate times throughout the group auditor.
- **Communication with group management and Those Charged with Governance (TCWG):** The standard also places emphasis on the communications with group management and TCWG of the group. The revised standard specifies matters that a group engagement team is required to communicate to TCWG such as fraud or suspected fraud involving component management of the group and also ensure that information from component auditors relevant to the group has been communicated.

- **Revised definition of an engagement team:** ISA 600 (Revised) incorporates the revised requirements of other standards such as ISA 220 (Revised). ISA 220 (Revised) has issued the revised definition of an engagement team. As per the revised definition, an engagement team shall include all partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement, excluding an auditor's external expert and internal auditors who provide direct assistance on an engagement. Considering the revised definition, under ISA 600 (Revised), engagement team includes group auditor and component auditor and thus, the component auditor is required to perform the audit in compliance with all other ISAs, as relevant.

- **Enhanced role and responsibility of group engagement partner:** The changes brought by ISA 600 (Revised) and ISA 220 (Revised) together aim to clarify and enhance the role and responsibility of the (group) engagement partner, in particular, in respect of their responsibility to proactively manage and achieve audit quality at the engagement level (complementing ISQM 1 and ISQM 2).

ISA 600 (Revised) emphasises the importance of professional skepticism. A group audit is required to direct, supervise, and review the work of engagement team members, including component auditors. This will help inform the group auditor about whether the engagement team has appropriately exercised professional skepticism.

Also to evaluate whether sufficient appropriate audit evidence has been obtained (including by component auditors) to provide a basis for forming an opinion on the group financial statements.

- **Involvement of the component auditor:**

The revised standard provides a framework for planning and performing a group audit engagement. The framework emphasises special considerations for establishing the overall group audit strategy and group audit plan and requires the group auditor to determine the nature, timing and extent of involvement of component auditors. It provides a robust framework for a component auditor's responsibilities with respect to the work to be performed on a component at the direction of the group engagement team, including communication with the group engagement team. It also highlights that component auditors can be, and often are, involved in all phases of the group audit including in risk assessment procedures.

Establishing clear and sufficiently detailed instructions for the component auditors is fundamental for the planning and performance of the group audit as it will be the basis for the direction of the component auditors by the group engagement team throughout the audit engagement. As mentioned earlier, the standard emphasises the importance of two-way communication between group and component auditors throughout the audit.



## Key considerations for management

The section below highlights some of the key considerations from management's perspective:

- a. **Background and understanding of the business and the organisation:**

The management is expected to provide complete information to the auditor regarding the organisation structure, business model, nature of operations including the locations at which the group has its operations or activities and extent to which the group's business model integrates the use of Information Technology (IT). The management should incorporate internal controls and communicate ethical and behavioral standards across the group (e.g., group-wide programmes, such as codes of conduct and fraud prevention programmes). The auditor should be informed regarding such internal controls, the extent of commonality of internal controls across the group. In case of shared service centers or service organisations are being used by the management, the same shall be informed to the group auditor to enable the auditor to plan the nature, timing and extent of the audit procedures to be performed.

- b. **Communication of significant matters:**

The management shall communicate significant matters that support the preparation of the group financial statements and related financial reporting responsibilities in the information system and other components of the group's

system of internal control. The group auditor would also request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit including significant deficiencies in internal control. Communications between regulatory authorities and entities or business units, including non-compliance or suspected non-compliance with laws or regulations that are relevant to the group audit should be communicated to the group auditor. The management should also discuss events or conditions identified by group management or component management that may cast significant doubt on the group's ability to continue as a going concern.

**c. Identification of related party relationships and transactions:** It is the primary responsibility of the group management to identify related party relationships and transactions and the same shall be communicated to the auditor. The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. In a group audit, there may be a higher risk of material misstatement of the group financial statements, including due to fraud, associated with related party relationships. Therefore, understanding the process for

identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework is imperative for a group auditor's understanding of the consolidation process and is an important consideration when component auditors are involved.

**d. Preparation of financial information/ statements:** The management shall be responsible for the preparation of the group financial statements. The management shall ensure whether uniform accounting policies are used to prepare the financial information of the components for the group financial statements and, if not, how differences in the accounting policies are identified and adjusted (when required by the applicable financial reporting framework). In order to achieve uniformity and comparability of financial information, the group management may issue instructions (e.g., communicate financial reporting policies) to the entities or business units that include details about financial reporting processes or may have policies that are common across the group. The group management should also incorporate a process for ensuring complete, accurate and timely financial reporting by the entities or business units in the group for the consolidation. Obtaining an understanding of group management's instructions is also important for the group auditor as it may affect

the identification and assessment of the risks of material misstatement of the group financial statements.

**e. Management's co-operation for ensuring quality audit:** The management shall provide the auditors access to all information of which that is relevant in the preparation of the group financial statements such as records, documentation and other matters. The management shall ensure unrestricted access is provided to the persons within the group from whom the engagement team determines it necessary to obtain audit evidence.



## Current scenario in India

In India, audit is conducted in accordance with Standards on Auditing (SAs) issued by the Institute of Chartered Accountants of India (ICAI). Currently, in a situation of a group with various components SA 600, *Using the Work of Another Auditor*, issued by ICAI permits the principal auditor to place reliance on the audit procedures performed by the component auditors in order to provide an opinion on the Consolidated Financial Statements (CFS) based on the audit report provided by the component auditors and comply by the principles and Guidance Note on Audit of Consolidated Financial Statements. Considering the auditing practices and conditions presently prevailing in India, ICAI would need to consider the requirements of the ISA 600 (Revised) and accordingly, decide whether it would be applicable in India.

Additionally, in case of listed companies, the Securities and Exchange Board of India (SEBI) through its circular dated 29 March 2019 has prescribed the procedure and formats for limited review report and audit report of the listed entity and its components to be followed by the statutory auditors of such entities. The circular reiterates that the audit and limited review of the respective components that are being consolidated with the parent company would continue to be undertaken

by the respective auditors of such components. The parent company management is responsible to ensure that there is co-ordination between principal and component auditor to comply with the requirements of SA 600.

Further, the circular provides detailed procedures for the principal auditor or group auditor to consider while performing the audit/review of the components of the listed entity. The circular requires the principal auditor to communicate the requirement to the component auditor on a timely basis. It also provides the formats for limited review reports and audit reports to be submitted by the statutory auditors. These formats require principal auditor to assess that the audit/review of the components has been performed by the component auditor and ensuring that the principal auditor has performed the procedures as per the SEBI circular while relying on the work of the component auditor. The SEBI vide circular no. CIR/CFD/CMD1/80/2019 dated, 19 July 2019 has issued revised formats for limited review/audit report of the listed entities and those entities whose accounts are to be consolidated with the listed entity.

## The bottom line

The new and revised requirements strengthen the group auditor's responsibilities relating to professional skepticism, planning, and performing a group audit and documentation. The introduction of the new risk-based approach would require a group auditor to determine an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. Also, it reinforces the need for clear and regular communication between group and component auditors throughout the audit. The standard sets out explicit requirements for communication on specific matters between the group auditor and the component auditors.

