

Alert

Updates on financial reporting and auditing



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Dear members,

Audits of group financial statements

HKSA 600 *Special Considerations – Audits of Group Financial Statements (including the Work of Component Audits)*, became effective for audits of financial statements for periods beginning on or after 15 December 2009. The clarified HKSA 600 was issued as part of the exercise to clarify standards. It is one of the few that changed quite significantly and contains a number of specific requirements that must be complied with by the group auditor. When HKSA 600 was first introduced, there were concerns over the practicability of some of these requirements, in particular those concerning involvement in the work of component auditors. Over almost two years of application, these concerns appear to have eased off gradually as practices begin to understand their respective roles in ensuring compliance with HKSA 600. This alert reminds members of the key requirements of HKSA 600 and sets out some of the more common issues identified in practice reviews concerning the application of HKSA 600.

Responsibilities of the group auditor under HKSA 600

- Responsible for direction, supervision and performance of the group audit engagement and the auditor's opinion on the group financial statements.
- Obtain an understanding of the group, its components and their environments, including significance of components, group wide controls, consolidation process and risks of material misstatement.
- If reliance is to be placed on the work of a component auditor, ensure that the component auditor meets the ethical requirements, has the necessary level of skills and competence required to carry out the work effectively and will allow the group auditor to be involved in its work to the extent necessary.
- Determine materiality level(s) for group and components, minimum levels of work to be performed for components depending on their significance or risks to the group and the nature, timing and extent of its involvement in component level work.
- Evaluate whether sufficient appropriate audit evidence has been obtained either from its own work or the work of component auditors on which to base the group audit opinion.
- Document an analysis of components and work performed on components, the nature, timing and extent of involvement in the work performed by the component auditors and communication with the component auditors.

Common issues identified in practice reviews on the application of HKSA 600

1. Restrictions on involvement of the group auditor in the work of component auditors

The most common issues identified in the application of HKSA 600 still surround the inability of the group auditor to be involved to the necessary extent in the work of component auditors. Circumstances include:

- Component auditors not responding to instructions issued by the group auditor;
- Group auditor not being able to take part in the risk assessment process of components and design of further audit procedures to address risks identified; and
- Group auditor not being able to gain access to component audit work papers kept by component auditors.

It is important for the group auditor to consider the extent to which it needs to be involved in component audits and whether appropriate arrangements can be made with component auditors at an early stage. If the group auditor cannot establish communication or arrangements with a component auditor, the group auditor may ask group management to request additional terms to be included in the engagement letter between the component management and the component auditor to require the component auditor to cooperate with the group auditor. If the group auditor is unable to ensure appropriate cooperation by the component auditor, the group auditor should plan to carry out audit work directly by themselves on components. If concerns are apparent before appointment and cannot be resolved, the group auditor should seriously consider whether it is appropriate to take on the appointment as group auditor. If concerns arise after appointment and sufficient appropriate audit evidence cannot be obtained in respect of the components, the group auditor should modify the group audit opinion.

2. Lack of understanding of the component auditors and evaluation of their work

There are circumstances where the group auditors do not obtain an understanding of component auditors or evaluate the work done by the component auditors. These include:

- Not assessing the independence, competence, capability and quality of the component auditor; and
- Relying on audited financial statements of significant components without carrying out any additional procedures.

These may be a consequence of the inability of the group auditor to be involved in the work of component auditors or because the group auditor does not fully understand the requirements of HKSA 600. It is the group auditor's responsibility to communicate relevant independence requirements and assess whether the component auditors have an understanding of applicable auditing and accounting standards. This can be achieved by requesting the component auditors to confirm in an acknowledgement letter (see appendix 4 of HKSA 600 for an example) or meeting with the component auditors and discussing the requirements.

As mentioned above the group auditor takes full responsibility for the auditor's opinion on the group financial statements and ensuring that sufficient appropriate audit procedures are performed by the component auditor if the group auditor intends to use the work of a component auditor to support the group audit opinion. Relying on the audited financial statements of significant components without carrying out any additional procedures would not satisfy the requirements of HKSA 600.

3. *Group audit planning, communication with component auditors and documentation*

In the middle ground, there is often room for improvement in the following areas:

- Group auditor not identifying significant components in the group in planning;

HKSA 600 advocates a risk based approach to a group audit such that audit effort can be focused on components that are considered significant to the group in terms of their size or risks. Focusing on significant components and issues that are important to the group should allow time and resources to be efficiently deployed.

- Group auditor not communicating significant issues identified at group level and materiality for component audits to the component auditors

For component auditors to fully contribute in achieving group audit objectives, it is important that the group auditor communicates significant risks identified at the group level and materiality for component audits to component auditors at the appropriate time. Appendix 5 of HKSA 600 sets out the required and additional matters that may be included in the group engagement team's letter of instruction. This is a good point of reference in determining the matters to be communicated to component auditors.

- Group auditor not adequately documenting the nature, timing and extent of its involvement in the work of component auditors.

It is important that sufficient documentation is kept on file to demonstrate that HKSA 600 has been complied with in carrying out a group audit. Reference can be made to HKSA 600 paragraph 50.

The quality assurance department will continue to monitor the application of HKSA 600 through its practice review programme and regularly bring to members' attention on issues identified to help improve audit practices in Hong Kong.

Sincere regards,

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