



Proposed Statement on Auditing Standards, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors) (Clean Draft)

Introduction

Scope of this Proposed SAS

- .1 Generally accepted auditing standards (GAAS) apply to an audit of group financial statements (a group audit). This proposed Statement on Auditing Standards (SAS) applies to all group audits. It addresses special considerations that apply to a group audit, including in those circumstances when component auditors are involved or when the group auditor makes reference to the audit of a referred-to auditor. The requirements and guidance in this proposed SAS refer to, or expand on, the application of other relevant AU-C sections to a group audit, in particular proposed SAS *Quality Management for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards* (proposed QM SAS),¹ AU-C section 230, *Audit Documentation*,² AU-C section 300, *Planning an Audit*,³ AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*,⁴ and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.⁵ (Ref: par. A1–A2)
- .2 Group financial statements include the financial information of more than one entity or business unit through a consolidation process, as described in paragraph .16. The term *consolidation process* as used in this proposed SAS 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. (Ref: par. A3–A5, A30)
- .3 Government entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.
- .4 As explained in proposed QM SAS,⁶ this proposed SAS, 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 proposed SAS 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 shared service center at a remote location.

Groups and Components

- .5 A group may be organized in various ways. For example, a group may be organized by legal or other entities (for example, 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

¹ Proposed QM SAS, *Quality Management for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*

² AU-C section 230, *Audit Documentation*

³ AU-C section 300, *Planning an Audit*

⁴ AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*

⁵ AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*

⁶ Paragraph A1 of proposed QM SAS

other economic units (including branches or divisions), or by functions or business activities. In this proposed SAS, these different forms of organization are collectively referred to as “entities or business units.” (Ref: par. A6)

- .6 The group auditor determines an appropriate approach to planning and performing audit procedures to respond to the assessed risks of material misstatement of the group financial statements. For this purpose, 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, the presence of shared service centers, or the existence of common information systems and controls. (Ref: par. A7–A9)

Involvement of Component Auditors

- .7 Proposed QM SAS⁷ 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, which are a part of the engagement team. Therefore, this proposed SAS requires the group auditor to determine the nature, timing, and extent of involvement of component auditors.
- .8 The group auditor may involve component auditors to provide information, or to perform audit work, to fulfill the requirements of this proposed SAS. Component auditors may have greater experience with, and a more in-depth knowledge of, the components and their environments (including local laws and regulations, business practices, language, and culture) than the group auditor. Accordingly, component auditors can be, and often are, involved in all phases of the group audit. (Ref: par. A10–A11)
- .9 Audit risk is a function of the risks of material misstatement and detection risk.⁸ Detection risk in a group audit includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements, and that the group auditor may not detect this misstatement. Accordingly, this proposed SAS requires sufficient and appropriate involvement by the group engagement partner or group auditor, as applicable, in the work of component auditors and emphasizes the importance of two-way communication between the group auditor and component auditors. In addition, this proposed SAS explains the matters that the group auditor takes into account when determining the nature, timing, and extent of the direction and supervision of component auditors and the review of their work. (Ref: par. A12–A13)

Making Reference to the Audit of a Referred-To Auditor

- .10 This proposed SAS also describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, a referred-to auditor is not a part of the engagement team. Therefore, when the terms *component auditor* and *engagement team* are used in this proposed SAS, they do not include referred-to auditors. Reference in the auditor’s report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor communicates the source of audit evidence with respect to those components for which such reference is made. The requirements in paragraphs .51.65 and the related application material are specific to referred-to auditors. Therefore, when the group engagement partner plans to make reference to the audit of a referred-to auditor in the auditor’s report on the group financial statements these requirements, in addition to other requirements, are relevant.

⁷ Paragraph 25 of proposed QM SAS

⁸ Paragraph A36 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*

Professional Skepticism

- .11 In accordance with AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*⁹ the engagement team is required to plan and perform the group audit with professional skepticism and to exercise professional judgment. The appropriate maintenance of professional skepticism may be demonstrated through the actions and communications of the engagement team, including emphasizing the importance of each engagement team member maintaining professional skepticism throughout the group audit. Such actions and communications may include specific steps to mitigate impediments that may impair the appropriate maintenance of professional skepticism. (Ref: par. A14–A18)

Scalability

- .12 This proposed SAS applies to all group audits, regardless of size or complexity. However, the requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each group audit. For example, when a group audit is carried out entirely by the group auditor, some requirements in this proposed SAS are not relevant because they are conditional on the involvement of component auditors or on making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. This may be the case when the group auditor is able to perform audit procedures centrally or when the group auditor is able to perform procedures at the components without involving component auditors or making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. The guidance in paragraphs A131 and A132 also may be helpful in applying this proposed SAS in these circumstances. (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios")

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Responsibilities of the Group Engagement Partner and Group Auditor

- .13 The group engagement partner remains ultimately responsible, and therefore accountable, for compliance with the requirements of this proposed SAS. The term "the group engagement partner should take responsibility for..." or "the group auditor should take responsibility for..." is used for those requirements when the group engagement partner or group auditor, respectively, is permitted to assign the design or performance of procedures, tasks, or actions to other appropriately skilled or suitably experienced members of the engagement team, including component auditors. For other requirements, this proposed SAS expressly intends that the requirement or responsibility be fulfilled by the group engagement partner or group auditor, as applicable, and the group engagement partner or group auditor may obtain information from the firm or other members of the engagement team. (Ref: par. A19, A33)

Effective Date

- .14 This proposed SAS is effective for audits of group financial statements for periods ending beginning on or after December 15, 2026⁵.

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Objectives

- .15 The objectives of the auditor are to do the following:
- a. With respect to the acceptance and continuance of the group audit engagement, determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained

⁹ Paragraphs 17-18 and A22-A28 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

to provide a basis for forming an opinion on the group financial statements

- b. 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
- c. 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
- d. Evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including with respect to the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, as a basis for forming an opinion on the group financial statements

Definitions

.16 For purposes of GAAS, the following terms have the meanings attributed as follows:

aggregation risk. The probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. (Ref: par. A20)

component. An entity, business unit, function or business activity, or some combination thereof, determined by the group auditor for purposes of planning and performing audit procedures in a group audit. (Ref: par. A21–A22)

component auditor. An auditor who performs audit work related to a component for purposes of the group audit. A component auditor is a part of the engagement team¹⁰ for a group audit. (Ref: par. A23–A26)

component management. Management responsible for a component. (Ref: par. A27)

component performance materiality. An amount set by the group auditor to reduce aggregation risk to an appropriately low level for purposes of planning and performing audit procedures in relation to a component.

group. A reporting entity for which group financial statements are prepared.

group audit. The audit of group financial statements.

group auditor. The group engagement partner and members of the engagement team other than component auditors. The group auditor is responsible for:

- i Establishing the overall group audit strategy and group audit plan;
- ii Directing and supervising component auditors and reviewing their work;
- iii Evaluating the conclusions drawn from the audit evidence obtained as the basis for forming an opinion on the group financial statements.

¹⁰ Paragraph 12 of proposed QM SAS

group audit opinion. The audit opinion on the group financial statements.

group engagement partner. The engagement partner¹¹ who is responsible for the group audit. (Ref: par. A28)

group financial statements. Financial statements that include the financial information of more than one entity or business unit through a consolidation process. For purposes of this proposed SAS, a consolidation process includes the following: (Ref: par. A29–A31)

- i. Consolidation, proportionate consolidation, inclusion, or an equity method of accounting;
- ii. The presentation in combined financial statements of the financial information of entities or business units that are under common control or common management; or
- iii. The aggregation of the financial information of entities or business units such as branches or divisions.

group management. Management responsible for the preparation of the group financial statements.

group performance materiality. Performance materiality¹² in relation to the group financial statements as a whole, as determined by the group auditor.

referred-to auditor. An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements. A referred-to auditor is not a component auditor, and accordingly, is not a part of the engagement team for a group audit.

- .17 Reference in this proposed SAS to “the applicable financial reporting framework” means the financial reporting framework that applies to the group financial statements. (Ref: par. A32)

Requirements

Leadership Responsibilities for Managing and Achieving Quality on a Group Audit

- .18 In applying proposed QM SAS,¹³ the group engagement partner is required to take overall responsibility for managing and achieving quality on the group audit engagement. In doing so, the group engagement partner should do the following: (Ref: par. A33–A34)
- a. Take responsibility for creating an environment for the group audit engagement that emphasizes the expected behavior of engagement team members (Ref: par. A35)
 - b. Be sufficiently and appropriately involved throughout the group audit engagement, including in the work of component auditors, such that the group engagement partner has the basis for determining whether the significant judgments made, and the conclusions reached, are appropriate given the nature and circumstances of the group audit engagement

Acceptance and Continuance

- .19 Before accepting or continuing the group audit engagement, the group engagement partner should

¹¹ Paragraph 12 of proposed QM SAS

¹² Paragraphs 9 and 11 of AU-C section 320, *Materiality in Planning and Performing an Audit*

¹³ Paragraph 13 of proposed QM SAS

determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained (including through involving component auditors or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements) to provide a basis for forming an opinion on the group financial statements. (Ref: par. A36–A43)

- .20 If, after the acceptance or continuance of the group audit engagement, the group engagement partner concludes that sufficient appropriate audit evidence cannot be obtained, the group engagement partner should consider the possible effects on the group audit. (Ref: par. A42)

Terms of Engagement

- .21 In applying AU-C section 210, *Terms of Engagement*¹⁴ the group auditor should obtain the agreement of group management that it acknowledges and understands its responsibility to provide the engagement team with the following: (Ref: par. A44)
- a. Access to all information of which group management is aware that is relevant to the preparation of the group financial statements such as records, documentation, and other matters
 - b. Additional information that the engagement team may request from group management or component management for the purpose of the group audit
 - c. Unrestricted access to persons within the group from whom the engagement team determines it necessary to obtain audit evidence

Restrictions on Access to Information or People Outside the Control of Group Management

- .22 If the group engagement partner concludes that group management cannot provide the engagement team with access to information or unrestricted access to persons within the group due to restrictions that are outside the control of group management, the group engagement partner should consider the possible effects on the group audit. (Ref: par. A45–A53)

Restrictions on Access to Information or People Imposed by Group Management

- .23 If the group engagement partner concludes that (Ref: par. A51–A53)
- a. it will not be possible for the group auditor to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and
 - b. the possible effect of this limitation will result in a disclaimer of opinion on the group financial statements, the group engagement partner should either,
 - i. in the case of an initial engagement, not accept the engagement, or, in the case of a recurring engagement, withdraw from the engagement, when withdrawal is possible under applicable law or regulation; or
 - ii. when the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements.

Overall Group Audit Strategy and Group Audit Plan

- .24 In applying AU-C section 300,¹⁵ the group auditor should establish, and update as necessary, an

¹⁴ Paragraphs 6(b) and 8(b) of AU-C section 210, *Terms of Engagement*

¹⁵ Paragraphs 7-10 of AU-C section 300

overall group audit strategy and group audit plan. In doing so, the group auditor should determine the following: (Ref: par. A54–A58)

- a. The components at which audit work will be performed (Ref: par. A59–A60)
- b. The resources needed to perform the group audit engagement, including the nature, timing, and extent to which component auditors are to be involved (Ref: par. A61–A65)
- c. The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor (see paragraphs .51-.65).

Considerations When Component Auditors Are Involved

- .25 In establishing the overall group audit strategy and group audit plan, the group engagement partner should evaluate whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor. (Ref: par. A66)
- .26 As part of the evaluation in paragraph .25, the group auditor should request the component auditor to confirm that the component auditor will cooperate with the group auditor, including whether the component auditor will perform the work requested by the group auditor. (Ref: par. A67)

Relevant Ethical Requirements, Including Those Related to Independence

- .27 In applying proposed QM SAS,¹⁶ the group engagement partner should take responsibility for the following: (Ref: par. A68–A69, A96)
 - a. Component auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement
 - b. Confirming whether the component auditors understand and will comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement.

Engagement Resources

- .28 In applying proposed QM SAS,¹⁷ the group engagement partner should do the following: (Ref: par. A70–A77)
 - a. Determine that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the component
 - b. If information about the results of the monitoring and remediation process or external inspections related to the component auditor has been provided by the group auditor's firm or has otherwise been made available to the group engagement partner, determine the relevance of such information to the group auditor's determination in paragraph .28a
- .29 The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor if
 - a. the component auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement;¹⁸ or (Ref: par. A78–A79)

¹⁶ Paragraph 17 of proposed QM SAS

¹⁷ Paragraphs 25-26 of proposed QM SAS

¹⁸ Paragraphs 15-16 of AU-C section 200

- b. the group engagement partner has serious concerns about the matters in paragraphs .25.28. (Ref: par. A80)

Engagement Performance

- .30 In applying proposed QM SAS,¹⁹ the group engagement partner should take responsibility for the nature, timing, and extent of direction and supervision of component auditors and the review of their work, taking into account the following: (Ref: par. A81–A86)
 - a. Areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with AU-C section 315
 - b. Areas in the audit of the group financial statements that involve significant judgment.

Communications with Component Auditors

- .31 The group auditor should communicate with component auditors about their respective responsibilities and the group auditor's expectations, including an expectation that communications between the group auditor and component auditors take place at appropriate times throughout the group audit. (Ref: par. A87–A96)

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control

- .32 In applying AU-C section 315,²⁰ the group auditor should take responsibility for obtaining an understanding of the following: (Ref: par. A97–A102)
 - a. The group and its environment, including (Ref: par. A103–A105)
 - i. the group's organizational structure and its business model, including
 - (1) the locations in which the group has its operations or activities;
 - (2) the nature of the group's operations or activities and the extent to which they are similar across the group; and
 - (3) the extent to which the group's business model integrates the use of IT;
 - ii. regulatory factors impacting the entities and business units in the group; and
 - iii. the measures used internally and externally to assess the entities or business units' financial performance;
 - b. The applicable financial reporting framework and the consistency of accounting policies and practices across the group
 - c. The group's system of internal control, including:
 - i. the nature and extent of commonality of controls; (Ref: par. A106–A109, A112)
 - ii. whether, and if so, how, the group centralizes activities relevant to financial

¹⁹ Paragraph 29 of proposed QM SAS

²⁰ Paragraphs 19-31 of AU-C section 315

reporting; (Ref: par. A110–A112)

- iii. the consolidation process used by the group, including sub-consolidations, if any, and consolidation adjustments; and
- iv. how group management communicates 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 to management of entities or business units. (Ref: par. A113–A115)

Considerations When Component Auditors Are Involved

- .33 The group auditor should communicate the following to component auditors on a timely basis: (Ref: par. A116)
 - a. Matters that the group auditor determines to be relevant to the component auditor's design or performance of risk assessment procedures for purposes of the group audit, including identified significant risks of the group financial statements
 - b. In applying AU-C section 550,²¹ related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the component auditor (Ref: par. A117–A118)
 - c. In applying AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*,²² events or conditions identified by group management or the group auditor, that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time that are relevant to the work of the component auditor
- .34 The group auditor should request component auditors to communicate the following on a timely basis:
 - a. Matters related to the financial information of the component that the component auditor determines to be relevant to the identification and assessment of the risks of material misstatement of the group financial statements, whether due to fraud or error
 - b. Related party relationships not previously identified by group management or the group auditor (Ref: par. A118)
 - c. Any events or conditions identified by the component auditor that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time

Identifying and Assessing the Risks of Material Misstatement

- .35 In applying AU-C section 315,²³ based on the understanding obtained in paragraph .32, the group auditor should 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. (Ref: par. A119–A124)

Considerations When Component Auditors Are Involved

²¹ Paragraph 19 of AU-C section 550, *Related Parties*
²² AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
²³ Paragraphs 32-38 of AU-C section 315

- .36 In applying AU-C section 315,²⁴ the group auditor should evaluate whether the audit evidence obtained from the risk assessment procedures performed by the group auditor and component auditors provides an appropriate basis for the identification and assessment of the risks of material misstatement of the group financial statements. (Ref: par. A125–A126)

Materiality

- .37 In applying AU-C section 320²⁵ and AU-C section 450, *Evaluation of Misstatements Identified During the Audit*,²⁶ 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, for those components on which the group auditor or component auditor will perform audit procedures, the group auditor should determine the following:
- a. Component performance materiality To address aggregation risk, such amount should be lower than group performance materiality. (Ref: par. A127–A133)
 - b. The threshold above which misstatements identified in the component financial information are to be communicated to the group auditor Such threshold should not exceed the amount regarded as clearly trivial to the group financial statements. (Ref: par. A134)

Considerations When Component Auditors Are Involved

- .38 The group auditor should communicate to the component auditor the amounts determined in accordance with paragraph .37. (Ref: par. A135–A136)

Responding to the Assessed Risks of Material Misstatement

- .39 In applying AU-C section 330,²⁷ the group auditor should 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. (Ref: par. A137–A153)

Consolidation Process

- .40 The group auditor should 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 should include the following: (Ref: par. A154)
- a. Evaluating whether all entities and business units have been included in the group financial statements as required by the applicable financial reporting framework and, if applicable, for designing and performing further audit procedures on sub consolidations
 - b. Evaluating the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications (Ref: par. A155)
 - c. Evaluating whether management's judgments made in the consolidation process give rise to indicators of possible management bias
 - d. Responding to assessed risks of material misstatement due to fraud arising from the

²⁴ Paragraph 39 of AU-C section 315

²⁵ Paragraph 11 of AU-C section 320

²⁶ Paragraph 5 of AU-C section 450, *Evaluation of Misstatements Identified During the Audit*

²⁷ Paragraphs 6-7 of AU-C section 330

consolidation process

- .41 If the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group auditor should evaluate whether the financial information has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework.
- .42 If the group financial statements include the financial information of an entity or business unit with a financial reporting period-end that differs from that of the group, the group auditor should take responsibility for evaluating whether appropriate adjustments have been made to that financial information in accordance with the applicable financial reporting framework.²⁸

Considerations When Component Auditors Are Involved

- .43 When the group auditor involves component auditors in the design or performance of further audit procedures, the group auditor should communicate with the component auditor about matters that the group auditor or component auditor determine to be relevant to the design of responses to the assessed risks of material misstatement of the group financial statements.
- .44 For areas of higher assessed risks of material misstatement of the group financial statements, or significant risks identified in accordance with AU-C section 315, on which a component auditor is determining the further audit procedures to be performed, the group auditor should evaluate the appropriateness of the design and performance of those further audit procedures. (Ref: par. A156))
- .45 When component auditors perform further audit procedures on the consolidation process, including on sub consolidations, the group auditor should determine the nature and extent of direction and supervision of component auditors and the review of their work. (Ref: par. A157)
- .46 The group auditor should determine whether the financial information identified in the component auditor's communication (see paragraph .47a) is the financial information that is incorporated in the group financial statements.

Evaluating the Component Auditor's Communications and the Adequacy of Their Work

- .47 The group auditor should request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include the following: (Ref: par. A158)
 - a. Identification of the financial information on which the component auditor has been requested to perform audit procedures
 - b. Whether the component auditor has performed the work requested by the group auditor
 - c. Whether the component auditor has complied with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement
 - d. Information about instances of noncompliance with laws or regulations
 - e. Corrected and uncorrected misstatements of the component financial information identified by the component auditor and that are above the threshold communicated by the group auditor in accordance with paragraph .38 (Ref: par. A159)

²⁸ See, for example, FASB Accounting Standards Codification Manual (ASC) 810, *Consolidation*

- f. Indicators of possible management bias
- g. Description of any deficiencies in the system of internal control identified in connection with the audit procedures performed
- h. Fraud or suspected fraud involving component management, employees at entities or business units who have significant roles in the group's system of internal control at the component, or others at entities or business units where the fraud resulted in a material misstatement of the component financial information
- i. Other significant matters that the component auditor communicated or expects to communicate to component management or those charged with governance of the component
- j. Any other matters that may be relevant to the group audit, or that the component auditor determines are appropriate to draw to the attention of the group auditor, including exceptions noted in written representations that the component auditor requested from component management
- k. The component auditor's overall findings or conclusions (Ref: par. A160)

.48 The group auditor should

- a. discuss significant findings and issues arising from communications with the component auditor, including those in accordance with paragraph .47, with the component auditor, component management, or group management, as appropriate; and
- b. evaluate whether communications with the component auditor are adequate for the group auditor's purposes. If such communications are not adequate for the group auditor's purposes, the group auditor should consider the implications for the group audit. (Ref: par. A161)

.49 The group auditor should determine whether, and the extent to which, it is necessary to review additional component auditor audit documentation. In making this determination, the group auditor should consider (Ref: par. A162A163)

- a. the nature, timing, and extent of the work performed by the component auditor;
- b. the competence and capabilities of the component auditor as determined in accordance with paragraph .28a; and
- c. the direction and supervision of the component auditor and review of their work.

.50 If the group auditor concludes that the work of the component auditor is not adequate for the group auditor's purposes, the group auditor should determine what additional audit procedures are to be performed, and whether they are to be performed by a component auditor or by the group auditor.

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Considerations Regarding Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements, Additional Procedures When Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements

Understanding the Referred-To Auditor

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors

- .51 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for (Ref: par. A165)
- a. referred-to auditors having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the group audit engagement; and
 - b. confirming whether the referred-to auditors understand and will comply with the ethical requirements that are relevant to the group audit engagement, including those related to independence.

Competence and Capabilities of Referred-To Auditors

- .52 When making reference to the audit of a referred-to auditor, the group engagement partner should take responsibility for determining that referred-to auditors have the appropriate competence and capabilities. (Ref: par. A166–A168)
- .53 The group auditor should obtain sufficient appropriate audit evidence relating to the work to be performed at the component without making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements if: (Ref: par. A169–A170)
- a. the referred-to auditor does not comply with the relevant ethical requirements, including those related to independence, that apply to the group audit engagement; or
 - b. the group engagement partner has serious concerns about the matters in paragraphs .51.52.

Consolidation Process Considerations for Referred-To Auditors

- .54 When making reference to the audit of a referred-to auditor, the group auditor should obtain an understanding of whether the group auditor will be able to obtain information affecting the consolidation process from group management or a referred-to auditor.

Determining Whether to Make Reference to the Audit of a Referred-To Auditor (Ref: par. A171–A178)

- .55 Having obtained an understanding of the referred-to auditor in paragraphs .51–.54, the group engagement partner should determine whether to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.
- .56 Reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless:
- a. the group engagement partner has determined that the referred-to auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS or the standards promulgated by the PCAOB (Ref: par. A174), and
 - b. the referred-to auditor has issued an auditor's report that is not restricted as to use.
- .57 If the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a referred-to auditor in the auditor's report on the group financial statements should not be made unless
- a. the measurement, recognition, presentation, and disclosure criteria that are applicable to material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to material

items in the group's financial statements under the financial reporting framework used by the group, and

- b. the group auditor has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to be involved in the audit of the component financial statements. (Ref: par. A174-A178)

.58 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the group auditor should obtain sufficient appropriate audit evidence with regard to such components by:

- a. performing the procedures required by this proposed SAS, as applicable (Ref: Exhibit A, "[Relevancy of Requirements in Various Group Audit Scenarios](#)") ~~related to making reference to the audit of a referred-to auditor~~; and
- b. reading the component's financial statements and the referred-to auditor's report thereon to identify significant findings and issues.

Commented [DAB4]:

Making Reference to the Audit of a Referred-To Auditor (Ref: par. A179–A182)

.59 When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the report on the group financial statements should clearly indicate the following:

- a. That the component was not audited by the group auditor but was audited by the referred-to auditor
- b. The magnitude of the portion of the financial statements audited by the referred-to auditor
- c. When the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements,
 - i. the financial reporting framework used by the component, and
 - ii. that the group auditor is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group in accordance with paragraph .41. (Ref: par. A175)
- d. When
 - i. the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and
 - ii. the group engagement partner has determined that the referred-to auditor performed additional audit procedures in order to meet the relevant requirements of GAAS,
 - (1) the set of auditing standards used by the referred-to auditor and
 - (2) that additional audit procedures were performed by the referred-to auditor to meet the relevant requirements of GAAS.

.60 If the group engagement partner determines to name a referred-to auditor in the auditor's report on the group financial statements,

- a. the referred-to auditor's express permission should be obtained and
- b. the referred-to auditor's report should be presented together with that of the auditor's report on the group financial statements.

.61 If the opinion of a referred-to auditor is modified or that audit report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section, the group auditor should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the group auditor should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section in the auditor's report on the group financial statements. (Ref. par. A182)

Communications With the Referred-To Auditor (Ref: par. A183-**Error! Reference source not found.**)

- .62 The group auditor should communicate the following to a referred-to auditor on a timely basis:
- a. In accordance with paragraph .51, the ethical requirements that are relevant to the group audit engagement, including those related to independence
 - b. Related party relationships or transactions identified by group management, and any other related parties of which the group auditor is aware, that are relevant to the work of the referred-to auditor (Ref: par. A184)
 - c. Identified significant risks of the group financial statements, whether due to fraud or error, that are relevant to the work of the referred-to auditor
 - d. A request that the referred-to auditor communicate the following on a timely basis:
 - i. Confirmation that the referred-to auditor will cooperate with the group auditor
 - ii. Related party relationships not previously identified by group management or the group auditor
 - iii. If the group engagement partner decides to name a referred-to auditor in the auditor's report on the group financial statements, the referred-to auditor's express permission for the group engagement partner to name the referred-to auditor in the auditor's report on the group financial statements in accordance with paragraph .60a.

- .63 The group auditor should request a referred-to auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. Such communication should include the following:
- a. Whether the referred-to auditor has complied with ethical requirements that are relevant to the group audit engagement, including independence
 - b. Identification of the financial information of the component on which the referred-to auditor is reporting
 - c. The referred-to auditor's report.

Evaluating a Referred-To Auditor's Communication

- .64 The group auditor should evaluate a referred-to auditor's communication (see paragraph .62d and .63). The group auditor should discuss significant findings and issues arising from that evaluation

with the referred-to auditor, component management, or group management, as appropriate.

- .65 The group auditor should determine whether the financial information identified in the referred-to auditor's communication (see paragraph .63b) is the financial information that is incorporated in the group financial statements.

Subsequent Events

- .66 In applying AU-C section 560,²⁹ the group auditor should take responsibility for performing procedures, including, as appropriate, requesting component auditors or referred-to auditors to perform procedures, designed to identify events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. A185–A187)

Considerations When Component Auditors Are Involved

- .67 The group auditor should request the component auditors to notify the group auditor if they become aware of subsequent events that may require adjustment of, or disclosure in, the group financial statements. (Ref: par. A187)

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

- .68 In applying AU-C section 330,³⁰ the group auditor should evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed, including from the work performed by component auditors, or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, on which to base the group audit opinion. (Ref: par. A188–A192)
- .69 The group engagement partner should evaluate the effect on the group audit opinion of any uncorrected misstatements (whether identified by the group auditor or communicated by component auditors) and any instances when there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. A193)

Auditor's Report

Considerations When Component Auditors Are Involved (Ref: par. A194–A195)

- .70 When component auditors are involved in the group audit, no reference should be made to the component auditor in the auditor's report on the group financial statements.

Communication with Group Management and Those Charged with Governance of the Group

Communication with Group Management

- .71 The group auditor should communicate with group management an overview of the planned scope and timing of the audit, including an overview of the work to be performed at components of the group. (Ref: par. A196)
- .72 If fraud has been identified by the group auditor or brought to its attention by a component auditor (see paragraph .47h) or referred-to auditor, or information indicates that a fraud may exist, the group auditor should 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

²⁹ Paragraphs 9-10 of AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*

³⁰ Paragraph 28 of AU-C section 330

fraud of matters relevant to their responsibilities. (Ref: par. A197)

- .73 When a component auditor or a referred to-auditor has been engaged to express an audit opinion on the financial statements of an entity or business unit that forms part of the group, the group auditor should request group management to inform management of the entity or business unit of any matter of which the group auditor becomes aware that may be significant to the financial statements of the entity or business unit, but of which management of the entity or business unit may be unaware. If group management refuses to communicate the matter to management of the entity or business unit, the group auditor should discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group auditor, subject to legal and professional confidentiality considerations, should consider whether to advise the component auditor or referred-to auditor not to issue the auditor's report on the financial statements of the entity or business unit until the matter is resolved and whether to withdraw from the engagement. (Ref: par. A198–A199)

Communication with Those Charged with Governance of the Group

- .74 The group auditor should communicate the following matters with those charged with governance of the group, in addition to those required by AU-C section 260, *The Auditor's Communication With Those Charged with Governance*³¹ and other AU-C sections: (Ref: par. A200)
- a. An overview of the work to be performed at the components of the group, including the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, and the nature of the group auditor's planned involvement in the work to be performed by component auditors (Ref: par. A201)
 - 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
 - c. Any limitations on the scope of the group audit, for example, significant matters related to restrictions on access to people or information
 - d. Fraud or suspected fraud involving group management, component management, employees at entities or business units who have significant roles in the group's system of internal control, or others at entities or business units in which a material misstatement of the group financial statements has or may have resulted from fraud

Communication of Identified Deficiencies in Internal Control

- .75 In applying AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*³² the group auditor should determine whether any identified deficiencies in the group's system of internal control are required to be communicated to those charged with governance of the group or group management. In making this determination, the group auditor should consider deficiencies in internal control that have been identified by component auditors and communicated to the group auditor in accordance with paragraph .47g. (Ref: par. A202)

Documentation

- .76 In accordance with AU-C section 230,³³ the audit documentation for a group audit engagement needs to be sufficient to enable an experienced auditor, having no previous connection with the

³¹ AU-C section 260, *The Auditor's Communication With Those Charged with Governance*

³² AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*

³³ Paragraph 8 of AU-C section 230

audit, to understand the nature, timing, and extent of audit procedures performed, the evidence obtained, and the conclusions reached with respect to significant matters arising during the group audit. In applying AU-C section 230,³⁴ the group auditor should include in the audit documentation the following: (Ref: par. A203–A206, A216–A219)

- a. Significant matters related to restrictions on access to people or information within the group that were considered before deciding to accept or continue the engagement, or that arose subsequent to acceptance or continuance, and how such matters were addressed
- b. The basis for the group auditor's determination of components for purposes of planning and performing the group audit (Ref: par. A207)
- c. The basis for the determination of component performance materiality and the threshold for communicating misstatements in the component financial information to the group auditor
- d. The basis for the group auditor's determination that component auditors have the appropriate competence and capabilities, including sufficient time, to perform the assigned audit procedures at the components (Ref: par. A208)
- e. Key elements of the understanding of the group's system of internal control in accordance with paragraph .32c
- f. 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 in accordance with paragraph .49 (Ref: par. A209–A215)
- g. Matters related to communications with component auditors, including
 - i. matters, if any, related to fraud, related parties, or going concern communicated in accordance with paragraph .34 and
 - ii. matters relevant to the group auditor's conclusion with regard to the group audit, in accordance with paragraph .47, including how the group auditor has addressed significant matters discussed with component auditors, component management, or group management.
- h. Those components for which reference to the audit of referred-to auditors is made in the auditor's report on the group financial statements, including the following for such components:
 - i. The financial statements of the component and the auditor's report of the referred-to auditor thereon
 - ii. When the referred-to auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the referred-to auditor met the relevant requirements of GAAS
 - iii. The basis for the group auditor's determination that referred-to auditors have the appropriate competence and capabilities

³⁴ Paragraphs 1-3, 9-12, A8-A9, and the Exhibit in AU-C section 230

- iv. Matters related to communications with referred-to auditors communicated in accordance with paragraphs .62d and .63, including how the group auditor has addressed significant matters discussed with referred-to auditors, component management, or group management
- i. The group auditor's evaluation of, and response to, findings or conclusions of the component auditors or referred-to auditors about matters that could have a material effect on the group financial statements

* * *

Application and Other Explanatory Material

Scope of this Proposed SAS (Ref: par. .1–.2)

- A1.** This proposed SAS also addresses the special considerations for the group engagement partner or group auditor, as applicable, in applying the requirements and guidance in proposed QM SAS, including for the direction and supervision of component auditors and the review of their work.
- A2.** Proposed Statement on Quality Management Standards (SQMS) 1, *A Firm's System of Quality Management*,³⁵ addresses the engagements for which an engagement quality review is required to be performed. Proposed SQMS 2, *Engagement Quality Reviews*,³⁶ addresses the appointment and eligibility of the engagement quality reviewer and the engagement quality reviewer's responsibilities relating to performing and documenting an engagement quality review, including for a group audit.
- A3.** An entity or business unit of a group may also prepare its own group financial statements that incorporate the financial information of those entities or business units it encompasses (that is, a sub-group). This proposed SAS applies to an audit of the group financial statements of such sub-groups performed for legal, regulatory, or other reasons. When the group auditor is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements (for example, when auditing a governmental entity), the auditor is responsible for reporting on each audit engagement in accordance with the AU-Cs.
- A4.** A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a bank with multiple branches. When those business units have characteristics such as separate locations, separate management, or separate information systems (including a separate general ledger) and the financial information is aggregated in preparing the single legal entity's financial statements, such financial statements meet the definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.
- A5.** In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity's financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (for example, in a subledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (for example, divisions) for purposes of this proposed SAS.

³⁵ Proposed Statement on Quality Management Standards (SQMS) 1, *A Firm's System of Quality Management*

³⁶ Proposed SQMS 2, *Engagement Quality Reviews*

Groups and Components (Ref: par. .5–6)

- A6.** The group's information system, including its financial reporting process, may or may not be aligned with the group's organizational structure. For example, a group may be organized according to its legal structure, but its information system may be organized by function, process, product, or service (or by groups of products or services), or geographic locations for management or reporting purposes.
- A7.** Based on the understanding of the group's organizational structure and information system, the group 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. For example, a group may have three legal entities with similar business characteristics, operating in the same geographical location, under the same management, and using a common system of internal control, including the information system. In these circumstances, the group auditor may decide to treat these three legal entities as one component.
- A8.** A group may also centralize activities or processes that are applicable to more than one entity or business unit within the group, for example through the use of a shared service center. When such centralized activities are relevant to the group's financial reporting process, the group auditor may determine that the shared service center is a component.
- A9.** Another consideration that may be relevant to the group auditor's determination of components is how management has determined operating segments in accordance with the disclosure requirements of the applicable financial reporting framework.³⁷

Involvement of Component Auditors (Ref: par. .7–9)

- A10.** Component auditors may perform an audit of the financial statements of a component, whether for legal, regulatory, or other reasons, particularly when a component is a legal entity. When a component auditor is also performing or has completed an audit of the component financial statements, the group auditor may be able to use audit work performed on the component financial statements, provided the group auditor is satisfied that such work is appropriate for purposes of the group audit. In addition, component auditors may adapt the work performed on the audit of the component financial statements to also meet the needs of the group auditor. In any event, the requirements of this proposed SAS apply, including those relating to the direction and supervision of component auditors and the review of their work.
- A11.** In accordance with proposed QM SAS,³⁸ the engagement partner is required to determine that the approach to direction, supervision, and review is responsive to the nature and circumstances of the audit engagement. Paragraph A85 provides examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work, and may be helpful in circumstances when the group auditor plans to use the audit work from an audit of component financial statements that has already been completed.
- A12.** As explained in AU-C section 200,³⁹ detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. Detection risk is a function not only of the effectiveness of an audit procedure but also the application of that procedure by the auditor. Therefore, detection risk is influenced by matters such as adequate planning, the assignment of appropriate resources to the engagement, the maintenance of professional skepticism, and the supervision and review of the audit work performed.

³⁷ See, for example, FASB Accounting Standards Codification Manual (ASC) 280, *Segment Reporting*

³⁸ Paragraph 30b of proposed QM SAS

³⁹ Paragraph A47 of AU-C section 200

A13. Detection risk is a broader concept than aggregation risk as described in paragraphs .16 and A20. In a group audit, there may be a higher probability that the aggregate of uncorrected and undetected misstatements may exceed materiality for the group financial statements as a whole because audit procedures may be performed separately on the financial information of components across the group. Accordingly, component performance materiality is set by the group auditor to reduce aggregation risk to an appropriately low level.

Professional Skepticism (Ref: par. .11)

A14. Proposed QM SAS⁴⁰ provides examples of the impediments to the maintenance of professional skepticism at the engagement level, including unconscious auditor biases that may impede the maintenance of professional skepticism when designing and performing audit procedures and evaluating audit evidence. Proposed QM SAS also provides possible actions that the engagement team may take to mitigate impediments to the maintenance of professional skepticism at the engagement level.

A15. Requirements and relevant application material in AU-C section 315,⁴¹ AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*,⁴² and other AU-C sections address the maintenance of professional skepticism, and include examples of how documentation may help provide evidence of the auditor's maintenance of professional skepticism.

A16. All members of the engagement team are required to maintain professional skepticism throughout the group audit. The group auditor's direction and supervision of engagement team members, including component auditors, and the review of their work, may inform the group auditor about whether the engagement team has appropriately maintained professional skepticism.

A17. The maintenance of professional skepticism in a group audit may be affected by matters such as the following:

- Component auditors in different locations may be subject to varying cultural influences, which may affect the nature of the biases to which they are subject.
- The complex structure of some groups may introduce factors that give rise to increased susceptibility to risks of material misstatement. In addition, an overly complex organizational structure may be a fraud risk factor in accordance with AU-C section 240⁴³ and therefore may require additional time or expertise to understand the business purpose and activities of certain entities or business units.
- The nature and extent of intragroup transactions (for example, transactions that involve multiple entities and business units within the group or multiple related parties), cash flows, or transfer pricing agreements may give rise to additional complexities. In some cases, such matters may also give rise to fraud risk factors.
- When the group audit is subject to tight reporting deadlines, this may put pressure on engagement team members when completing the work assigned. In these circumstances, the engagement team may need to take additional time to appropriately question management's assertions, make appropriate judgments, or appropriately review the audit work performed.

A18. The maintenance of professional skepticism by the group auditor includes remaining alert for inconsistent information from component auditors, component management, and group

⁴⁰ Paragraphs A34-A36 of proposed QM SAS

⁴¹ Paragraph A268 of AU-C section 315

⁴² Paragraph A11 of AU-C section 540, *Auditing Accounting Estimates and Related Disclosures*

⁴³ Appendix A of AU-C section 240, *Consideration of Fraud in a Financial Statement Audit*

management about matters that may be significant to the group financial statements.

Responsibilities of the Group Engagement Partner and Group Auditor (Ref: par. .13)

A19. Component auditors may perform work on the financial information of the components for the group audit or reference may be made to the audit of a referred-to auditor in the auditor's report on the group financial statements and as such, component auditors and referred-to auditors are responsible for their overall findings or conclusions. However, regardless of whether reference is made in the auditor's report on the group financial statements to the report of a referred-to auditor, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.

Definitions

Aggregation Risk (Ref: par. .16)

A20. Aggregation risk exists in all audits of financial statements, but is particularly important to understand and address in a group audit because there is a greater likelihood that audit procedures will be performed on classes of transactions, account balances, or disclosures that are disaggregated across components. Generally, aggregation risk increases as the number of components increases at which audit procedures are performed separately, whether by component auditors or other members of the engagement team.

Component (Ref: par. .16)

A21. The group auditor uses professional judgment in determining components at which audit work will be performed. Paragraph A7 explains that the financial information of certain entities or business units may be considered together for purposes of planning and performing audit procedures. However, the group auditor's responsibility for the identification and assessment of the risks of material misstatement of the group financial statements encompasses all of the entities and business units whose financial information is included in the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. .16)

A22. In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

Component Auditor (Ref: par. .16)

A23. References in this proposed SAS to the engagement team include the group auditor and component auditors. Component auditors may be from a network firm, a firm that is not a network firm, or the group auditor's firm (for example, another office within the group auditor's firm).

A24. An auditor who performs work on a component when the group auditor will not use that work to provide audit evidence for the group audit is not considered a component auditor.

A25. In some circumstances, the group auditor may perform centralized testing on classes of transactions, account balances, or disclosures, or may perform audit procedures related to a component. In these circumstances, the group auditor is not considered a component auditor.

A26. Paragraph .26 requires the group auditor to request the component auditor to confirm that the component auditor will cooperate with the group auditor and perform the work requested by the group auditor. Paragraph A67 provides guidance for circumstances in which the component auditor is unable to provide such a confirmation.

Component Management (Ref: par. .16)

- A27.** Component management refers to management responsible for the financial information or other activity (for example, processing of transactions at a shared service center) at an entity or business unit that is part of the group. When the group auditor considers the financial information of certain entities or business units together as a component or determines that a shared service center is a component (see paragraphs A7–A8), component management refers to the management that is responsible for the financial information or transaction processing that is subject to the audit procedures being performed in relation to that component. In some circumstances, there may not be separate component management and group management may be directly responsible for the financial information or other activities of the component.

Group Engagement Partner (Ref: par. .1616j)

- A28.** When joint auditors conduct a group audit, the joint engagement partners and their engagement teams collectively constitute the “group engagement partner” and “engagement team” for the purposes of GAAS. This proposed SAS does not, however, deal with the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor for purposes of the group audit.

Group Financial Statements (Ref: par. .2, .1616)

- A29.** The requirements for the preparation and fair presentation of the group financial statements may be specified in the applicable financial reporting framework, which may therefore affect the determination of the financial information of entities or business units to be included in the group financial statements. For example, some frameworks require the preparation of consolidated financial statements when an entity (a parent entity) controls one or more other entities (for example, subsidiaries) through majority ownership interest or other means. In some cases, the applicable financial reporting framework includes separate requirements for, or may otherwise permit, the presentation of combined financial statements. Examples of circumstances in which the presentation of combined financial statements may be permitted include entities that are under common control or entities under common management.
- A30.** The term “consolidation process” as used in this proposed SAS is not intended to have the same meaning as “consolidation” or “consolidated financial statements” as defined or described in financial reporting frameworks. Rather, the term “consolidation process” refers more broadly to the process used to prepare group financial statements.
- A31.** The detailed aspects of the consolidation process vary from one group to another, depending on the group’s structure and information system, including the financial reporting process. However, a consolidation process involves considerations such as the elimination of intra-group transactions and balances and, when applicable, implications of different reporting periods for entities or business units included in the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. .1, .17)

- A32.** In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

Leadership Responsibilities for Managing and Achieving Quality on a Group Audit (Ref: par. .13, .18)

- A33.** It may not be possible or practical for the group engagement partner to solely deal with all requirements in proposed QM SAS, particularly when the engagement team includes a large number of component auditors located in multiple locations. In managing quality at the engagement

level, proposed QM SAS⁴⁴ permits the engagement partner to assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the engagement partner. Accordingly, the group engagement partner may assign procedures, tasks, or actions to other members of the engagement team and these members may assign procedures, tasks, or actions further. In such circumstances, proposed QM SAS requires that the engagement partner should continue to take overall responsibility for managing and achieving quality on the audit engagement.

- A34.** Policies or procedures established by the firm, or that are common network requirements or network services,⁴⁵ may support the group engagement partner by facilitating communication between the group auditor and component auditors and supporting the group auditor's direction and supervision of those component auditors and the review of their work.
- A35.** Proposed QM SAS⁴⁶ explains that a culture that demonstrates a commitment to quality is shaped and reinforced by the engagement team members as they demonstrate expected behaviors when performing the engagement. In addressing the requirement in paragraph .18a, the group engagement partner may communicate directly to other members of the engagement team (including component auditors) and reinforce this communication through personal conduct and actions (for example, leading by example).

Acceptance and Continuance

Determining Whether Sufficient and Appropriate Audit Evidence Can Reasonably Be Expected to Be Obtained (Ref: par. .19–.20)

- A36.** In determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained, the group engagement partner may obtain an understanding of matters such as the following:
- The group structure, including both the legal and organizational structure
 - Activities that are significant to the group, including the industry and regulatory, economic, and political environments in which those activities take place
 - The use of service organizations
 - The use of shared service centers
 - The consolidation process
 - Whether the group auditor
 - will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management and component information, including of those components that are accounted for by the equity method; and
 - will be able to perform necessary work on the financial information of the components when applicable
 - Whether sufficient and appropriate resources are assigned or will be made available

⁴⁴ Paragraph 15 of proposed QM SAS

⁴⁵ Paragraphs 49-53 of proposed SQMS 1

⁴⁶ Paragraph A28 of proposed QM SAS

A37. In the case of an initial group audit engagement, the group auditor's understanding of the matters in paragraph A36 may be obtained from

- information provided by group management;
- communication with group management;
- communication with those charged with governance of the group; and
- when applicable, communication with component management or the predecessor auditor.

A38. For a recurring engagement, the ability to obtain sufficient appropriate audit evidence may be affected by significant changes, for example, changes in the following:

- The group structure (for example, acquisitions, disposals, joint ventures, reorganizations, or changes in how the group financial reporting system is organized)
- Components' activities that are significant to the group
- The composition of those charged with governance of the group, group management, or key management of components for which audit procedures are expected to be performed
- The group auditor's understanding of the integrity and competence of group or component management
- Changes in the applicable financial reporting framework

A39. There may be additional complexities with obtaining sufficient appropriate audit evidence in a group audit when components are located in jurisdictions other than the group auditor's jurisdiction because of cultural and language differences, and different laws or regulations. For example, law or regulation may restrict the component auditor from providing documentation outside of its jurisdiction, or war, civil unrest or outbreaks of disease may restrict the group auditor's access to relevant component auditor audit documentation. Paragraph A217 includes possible ways to address these situations.

A40. In addition to the work performed by the group auditor, the group engagement partner may obtain sufficient appropriate audit evidence regarding the financial information of one or more components through using the work of a component auditor or through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

A41. There may be more complexities in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained in a group audit where reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, including in group audits where no component auditors are also involved. The group engagement partner may consider the nature and extent of work performed by referred-to auditors, including matters such as the following:

- The financial significance of the components that are audited by referred-to auditors
- The risks of material misstatement to the group financial statements associated with the portion of the company's financial statements for which the group auditor or component auditor performs audit procedures, in comparison with the portion audited by referred-to auditors

Commented [DAB5]:

As the magnitude of the portion of the financial statements that is audited by referred-to auditors increases, it is less likely that the group engagement partner can conclude that sufficient appropriate audit evidence can be obtained.

A42. Restrictions may be imposed after the group engagement partner's acceptance of the group audit engagement that may affect the engagement team's ability to obtain sufficient appropriate audit evidence. Such restrictions may include those affecting

- the group auditor's access to component information, management or those charged with governance of components, or the component auditors (including relevant audit documentation sought by the group auditor) (see paragraphs .22.20 and .23); or
- the work to be performed on the financial information of components.

Paragraphs A52–A53 explain the possible effect of such restrictions on the auditor's report on the group financial statements.

Considerations Specific to Governmental Entities (Ref: par. .19)

A43. In audits of state and local governments, when reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, the following are additional factors to consider in determining whether sufficient appropriate audit evidence can reasonably be expected to be obtained:

- Engagement by the primary government as the auditor of the financial reporting entity
- Responsibility for auditing the primary government's general fund (or other primary operating fund).

Agreeing the Terms of Audit Engagements (Ref: par. .21)

A44. AU-C section 210⁴⁷ requires the auditor to agree upon the terms of the audit engagement with management or those charged with governance, as appropriate. The terms of engagement identify the applicable financial reporting framework. Additional matters that may be included in the terms of a group audit engagement include whether reference will be made to the audit of a referred-to auditor in the auditor's report on the group financial statements, when relevant, or arrangements to facilitate the following:

- Unrestricted communications between the group auditor and component auditors, to the extent permitted by laws or regulations
- Communications to the group auditor of important communications between
 - component auditors and those charged with governance of the component or component management, including communications on significant deficiencies and material weaknesses in internal control and
 - regulatory authorities and entities or business units related to financial reporting matters that may be relevant to the group audit
- Permission for the group auditor to perform work, or request a component auditor to perform work, at the component

⁴⁷ Paragraphs 9 and 10(e) of AU-C section 210

Restrictions on Access to Information or People (Ref: par. .22--23)

- A45.** Restrictions on access to information or people do not eliminate the requirement for the group auditor to obtain sufficient appropriate audit evidence.
- A46.** Access to information or people can be restricted for many reasons, such as restrictions imposed by component management, laws or regulations or other conditions, for example, war, civil unrest, or outbreaks of disease. Paragraph A217 describes how the group auditor may be able to overcome restrictions on access to component auditor audit documentation.
- A47.** In some circumstances, the group auditor may be able to overcome restrictions on access to information or people, for example,
- if access to component management or those charged with governance of the component is restricted, the group auditor may request group management or those charged with governance of the group to assist with removing the restriction or otherwise request information directly from group management or those charged with governance of the group.
 - if the group has a noncontrolling interest in an entity that is accounted for by the equity method, the group auditor may determine whether provisions exist (for example, in the terms of joint venture agreements, or the terms of other investment agreements) regarding access by the group to the financial information of the entity and request group management to exercise such rights.
 - If the group has a noncontrolling interest in an entity that is accounted for by the equity method and the group has representatives who are on the executive board or are members of those charged with governance of the non-controlled entity, the group auditor may inquire whether they can provide financial and other information available to them in these roles.
- A48.** If the group has a noncontrolling interest in an entity that is accounted for by the equity method and the group auditor's access to information or people at the entity is restricted, the group auditor may be able to obtain information to be used as audit evidence regarding the entity's financial information, for example, from the following:
- Financial information that is available from group management, as group management also needs to obtain the noncontrolled entity's financial information in order to prepare the group financial statements
 - Publicly available information, such as audited financial statements, public disclosure documents, or quoted prices of equity instruments in the noncontrolled entity
 - Financial statements audited by a referred-to auditor when the group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements

It is a matter of professional judgment, particularly in view of the assessed risks of material misstatement of the group financial statements and considering other sources of information that may corroborate or otherwise contribute to audit evidence obtained, whether the auditor can obtain sufficient appropriate audit evidence.⁴⁸

- A49.** If the group has a noncontrolling interest in an entity that is accounted for by the equity method and

⁴⁸ Paragraph 7(b) of AU-C section 330

access to information or people at the entity is restricted, the group auditor may consider whether such restrictions are inconsistent with group management's assertions regarding the appropriateness of the use of the equity method of accounting.

- A50.** When the group auditor is unable to obtain sufficient appropriate audit evidence due to restrictions on access to information or people, the group auditor may
- communicate the restrictions to the group auditor's firm to assist the group auditor in determining an appropriate course of action. For example, the group auditor's firm may communicate with group management about the restrictions and encourage group management to communicate with regulators. This may be useful when restrictions affect multiple audits in the jurisdiction or by the same firm, for example, because of war, civil unrest, or outbreaks of disease in a major economy.
 - be required by law or regulation to communicate with regulators, listing authorities, or others, about the restrictions.
- A51.** Restrictions on access may have other implications for the group audit. For example, if restrictions are imposed by group management, the group auditor may need to reconsider the reliability of group management's responses to the group auditor's inquiries and whether the restrictions call into question group management's integrity.

Effect of Restrictions on Access to Information or People on the Auditor's Report on Group Financial Statements

- A52.** AU-C section 705⁴⁹ contains requirements and guidance about how to address situations when the group auditor is unable to obtain sufficient appropriate audit evidence. Illustration 1 in Exhibit B "Illustrative Auditor's Reports on Group Financial Statements," contains an example of an auditor's report containing a qualified group audit opinion based on the group auditor's inability to obtain sufficient appropriate audit evidence in relation to a component that is accounted for by the equity method.

Law or Regulation Prohibit the Group Engagement Partner from Declining or Withdrawing from an Engagement

- A53.** AU-C Section 210 addresses circumstances when an entity is required by law or regulation to have an audit. In these circumstances, this proposed SAS still applies to the group audit, and the effect of the group auditor's inability to obtain sufficient appropriate audit evidence is addressed in AU-C section 705.

Overall Group Audit Strategy and Group Audit Plan

The Continual and Iterative Nature of Planning and Performing a Group Audit (Ref: par. .24)

- A54.** As explained in AU-C section 300,⁵⁰ planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. For example, due to unexpected events, changes in conditions, or audit evidence obtained from risk assessment or further audit procedures, the group auditor may need to modify the overall group audit strategy and group audit plan, and the resulting planned nature, timing, and extent of further audit procedures, based on the revised consideration of assessed risks. The group auditor may also modify the determination of the components at which to perform audit work as well as the

⁴⁹ AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*

⁵⁰ Paragraph A2 of AU-C section 300

nature, timing, and extent of the component auditors' involvement. AU-C section 300⁵¹ requires the auditor to update and change the overall audit strategy and audit plan as necessary during the course of the audit.

- A55.** The form of the group audit strategy and group audit plan may vary based on the nature and circumstances of each group audit engagement, including the extent to which engagement management is integrated into the audit tools used for the group audit. An electronic audit tool may be used to develop and update the group audit strategy and audit plan, and facilitate the group engagement partner's review of the group audit plan and group audit strategy.

Establishing the Overall Group Audit Strategy and Group Audit Plan (Ref: par. .24)

- A56.** In an initial group audit engagement, the group auditor may have a preliminary understanding of the group and its environment, the applicable financial reporting framework, and the entity's system of internal control based on information obtained from group management, those charged with governance of the group and, when applicable, communication with component management or the predecessor auditor. In a recurring group audit engagement, the group auditor's preliminary understanding may be obtained through prior period audits. This preliminary understanding may assist the group auditor in developing initial expectations about the classes of transactions, account balances, and disclosures that may be significant.
- A57.** The group auditor may also use information obtained during the engagement acceptance and continuance process in establishing the overall group audit strategy and group audit plan, for example, in relation to the resources needed to perform the group audit.
- A58.** The process of establishing the overall group audit strategy and group audit plan and initial expectations about the classes of transactions, account balances, and disclosures that may be significant at the group financial statement level may assist the group auditor in developing a preliminary determination of matters such as the following:
- Whether to perform audit work centrally, at components or a combination thereof
 - The nature, timing, and extent of audit work to be performed with respect to the financial information of components (for example, design and perform risk assessment procedures, further audit procedures, or a combination thereof)
 - The components for which, if any, the auditor's report on the group financial statements will make reference to the audit of a referred-to auditor

Components at Which to Perform Audit Work (Ref: par. .24a)

- A59.** The determination of components at which to perform audit work is a matter of professional judgment. The following are examples of matters that may influence the group auditor's determination:
- 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, for example,
 - newly formed or acquired entities or business units.
 - entities or business units in which significant changes have taken place.
 - significant transactions with related parties.

⁵¹ Paragraph 10 of AU-C section 300

- significant unusual transactions.
- abnormal fluctuations identified by analytical procedures performed at the group level, in accordance with AU-C section 315.⁵²
- 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

Considerations Specific to Governmental Entities (Ref: par. .24a)

A60. In audits of governmental entities, the following are examples of matters that may influence the group auditor's determination of components at which to perform audit work:

- The disaggregation of significant classes of transactions, account balances, and disclosures (for example, net costs or total budget) in the group financial statements across components, considering the size and nature of assets, liabilities, and transactions, at the component unit, business activity, department, or program relative to the group financial statements
- The materiality of the component relative to its related opinion unit, as set forth in the *AICPA State and Local Governments – Audit and Accounting Guide*
- Matters of heightened public sensitivity, such as national security issues, donor funded projects, or reporting of tax revenue

Resources (Ref: par. .24b)

A61. Matters that influence the group auditor's determination of the resources needed to perform the group audit and the nature, timing, and extent to which component auditors are to be involved are a matter of professional judgment. The following are examples of such matters:

- The understanding of the group, the components within the group at which audit work is to be performed, and whether to perform work centrally, at components, or a combination thereof
- The knowledge and experience of the engagement team. For example, component auditors may have greater experience and a more in-depth knowledge than the group auditor of the local industries in which components operate, local laws or regulations, business practices, language, and culture. In addition, the involvement of auditor's specialists may be needed on complex matters

⁵² Paragraph 14(b) of AU-C section 315

- The initial expectations about the potential risks of material misstatement
- The amount or location of resources to allocate to specific audit areas. For example, the extent to which components are dispersed across multiple locations may impact the need to involve component auditors in specific locations
- Access arrangements. For example, when the group auditor's access to a component in a particular jurisdiction is restricted, component auditors may need to be involved
- The nature of the components' activities, including their complexity or specialization of operations
- The group's system of internal control, including the information system in place, and its degree of centralization. For example, the involvement of component auditors may be more likely when the system of internal control is decentralized
- Previous experience with the component auditor

A62. Component auditors may be involved in different phases of an audit, for example, component auditors may design or perform

- risk assessment procedures; and
- procedures to respond to the assessed risks of material misstatement.

A63. The nature, timing, and extent to which component auditors are to be involved depends on the facts and circumstances of the group audit engagement. Often component auditors will be involved in all phases of the audit, but the group auditor may decide to involve component auditors only in a certain phase. When the group auditor does not intend to involve component auditors in risk assessment procedures, the group auditor may still discuss with component auditors whether there are any significant changes in the business or the system of internal control of the component that could have an effect on the risks of material misstatement of the group financial statements.

A64. AU-C section 300⁵³ requires the engagement partner and other key members of the engagement team to be involved in planning the audit. When component auditors are involved, one or more individuals from a component auditor may be key members of the engagement team and therefore involved in planning the group audit. The involvement of component auditors in planning the audit draws on their experience and insight, thereby enhancing the effectiveness and efficiency of the planning process. The group engagement partner uses professional judgment in determining which component auditors to involve in planning the audit. This may be affected by the nature, timing, and extent to which the component auditors are expected to be involved in designing and performing risk assessment or further audit procedures.

A65. As described in proposed SQMS 1,⁵⁴ there may be circumstances when the fee quoted for an engagement is not sufficient given the nature and circumstances of the engagement, and it may diminish the firm's ability to perform the engagement in accordance with professional standards and applicable legal or regulatory requirements. The level of fees, including, when applicable, their allocation to component auditors, and the extent to which they relate to the resources required may be a special consideration for group audit engagements. For example, in a group audit, the firm's financial and operational priorities may place constraints on the determination of the components at which audit work will be performed, as well as the resources needed, including the involvement

⁵³ Paragraph 5 of AU-C section 300

⁵⁴ Paragraph A78 of proposed SQMS 1

of component auditors. In such circumstances, these constraints do not alleviate the group engagement partner's responsibility for achieving quality at the engagement level or the requirements for the group auditor to obtain sufficient appropriate audit evidence on which to base the group audit opinion.

Considerations When Component Auditors Are Involved

Sufficient and Appropriate Involvement in the Work of the Component Auditor (Ref: par. .25–.26)

- A66.** In evaluating whether the group auditor will be able to be sufficiently and appropriately involved in the work of the component auditor, the group auditor may obtain an understanding of whether the component auditor is subject to any restrictions that limit communication with the group auditor, including with regard to sharing audit documentation with the group auditor. The group auditor may also obtain an understanding about whether audit evidence related to components located in a different jurisdiction may be in a different language and may need to be translated for use by the group auditor.
- A67.** If the component auditor is unable to cooperate with the group auditor, the group auditor may do the following
- Request the component auditor to provide its rationale
 - Be able to take appropriate action to address the matter, including adjusting the nature of the work requested to be performed. Alternatively, in accordance with paragraph .29, the group auditor may need to obtain sufficient appropriate audit evidence relating to the work to be performed at the component without involving the component auditor.

Relevant Ethical Requirements, Including Those Related to Independence (Ref: par. .27)

- A68.** When performing work at a component for a group audit engagement, the component auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit engagement. Such requirements may be different from or in addition to those applying to the component auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the component auditor's jurisdiction. When the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Federation of Accountants *Code of Ethics for Professional Accountants* is sufficient to fulfill the component auditor's ethical responsibilities in the group audit.
- A69.** In making the component auditor aware of relevant ethical requirements, the group auditor may consider whether additional information or training for component auditors is necessary regarding the provisions of the ethical requirements that are relevant to the group audit engagement.

Engagement Resources (Ref: par. .28)

- A70.** Proposed QM SAS⁵⁵ 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. When sufficient or appropriate resources are not made available in relation to work to be performed by a component auditor, the group engagement partner may discuss the matter with the component auditor, group management, or the group auditor's firm and may subsequently request the component auditor or the group auditor's firm to make sufficient and appropriate resources available.

⁵⁵ Paragraph 25 of proposed QM SAS

Competence and capabilities of the component auditors

- A71.** Proposed QM SAS⁵⁶ provides guidance regarding matters the engagement partner may take into consideration when determining the competence and capabilities of the engagement team. This determination is particularly important in a group audit when the engagement team includes component auditors. Proposed QM SAS⁵⁷ indicates that the firm's policies or procedures may require the firm or the engagement partner to take different actions from those applicable to personnel when obtaining an understanding of whether a component auditor from another firm has the appropriate competence and capabilities to perform the audit engagement.
- A72.** Determining whether component auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement. This determination influences the nature, timing, and extent of the group engagement partner's direction and supervision of the component auditor and the review of their work.
- A73.** In determining whether component auditors have the appropriate competence and capabilities to perform the assigned audit procedures at the component, the group engagement partner may consider matters such as the following:
- Previous experience with or knowledge of the component auditor
 - The component auditor's specialized skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies)
 - The component auditor's understanding of the auditing and other standards applicable to the group audit, such as GAAS, that is sufficient to fulfill the component auditor's responsibilities
 - The degree to which the group auditor and component auditor are subject to a common system of quality management, for example, whether the group auditor and a component auditor
 - use common resources to perform the work (for example, audit methodologies or information technology (IT) applications);
 - share common policies or procedures affecting engagement performance (for example, direction, supervision, and review of work or consultation);
 - are subject to common monitoring activities; or
 - have other commonalities, including common leadership or a common cultural environment.
 - The consistency or similarity of
 - laws or regulations or legal system;
 - language and culture;
 - education and training;

⁵⁶ Paragraph A71 of proposed QM SAS

⁵⁷ Paragraph A24 of proposed QM SAS

- professional oversight, discipline, and external quality assurance; or
- professional organizations and standards.
- Information obtained about the component auditor through interactions with component management, those charged with governance, and other key personnel, such as internal auditors

A74. The procedures to determine the component auditor's competency and capability may include, for example, the following:

- An evaluation of the information communicated by the group auditor's firm to the group auditor, including
 - the firm's ongoing communication related to monitoring and remediation, in circumstances when the group auditor and component auditor are from the same firm.⁵⁸
 - information from the network about the results of the monitoring activities undertaken by the network across the network firms.⁵⁹
 - information obtained from professional body(ies) to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.
- Discussing the assessed risks of material misstatement with the component auditor
- Requesting the component auditor to confirm their understanding of the matters referred to in paragraph .27 in writing
- Discussing the component auditor's competence and capabilities with colleagues in the group engagement partner's firm that have worked directly with the component auditor
- Obtaining published external inspection reports, peer review reports on the component auditor's firm, and other relevant publicly available information relating to the professional reputation and standing of a component auditor

A75. The group engagement partner's firm and the component auditor may be members of the same network and may be subject to common network requirements or use common network services.⁶⁰ When determining whether component auditors have the appropriate competence and capabilities to perform work in support of the group audit engagement, the group engagement partner may be able to depend on such network requirements, for example, those addressing professional training, or recruitment or that require the use of audit methodologies and related implementation tools. In accordance with proposed SQMS 1,⁶¹ the firm is responsible for designing, implementing, and operating its system of quality management, and the firm may need to adapt or supplement network requirements or network services to be appropriate for use in its system of quality management.

Using the work of an auditor's specialist

⁵⁸ Paragraph 48 of proposed SQMS 1

⁵⁹ Paragraph 52(b) of proposed SQMS 1

⁶⁰ Paragraphs A20 and A188 of proposed SQMS 1

⁶¹ Paragraphs 49-50 of proposed SQMS 1

A76. Proposed QM SAS⁶² requires the engagement partner to determine that members of the engagement team, and any auditor's external specialists who are not part of the engagement team, collectively have the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. If an auditor's specialist is used by a component auditor, the group engagement partner may need to obtain information from the component auditor. For example, the group auditor may discuss with the component auditor, the component auditor's evaluation of the competence and capabilities of the auditor's specialist.

Automated tools and techniques

A77. When determining whether the engagement team has the appropriate competence and capabilities, the group engagement partner may take into consideration such matters as the expertise of the component auditor in the use of automated tools and techniques. For example, as described in proposed QM SAS,⁶³ when the group auditor requires component auditors to use specific automated tools and techniques when performing audit procedures, the group auditor may communicate with component auditors that the use of such automated tools and techniques need to comply with the group auditor's instructions.

Application of the Group Auditor's Understanding of a Component Auditor (Ref: par. .29)

A78. Proposed QM SAS⁶⁴ requires the engagement partner to take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm's related policies or procedures. This includes the firm's policies or procedures that address circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and the responsibilities of members of the engagement team when they become aware of breaches. The firm's policies or procedures also may address breaches of independence requirements by component auditors, and actions the group auditor may take in those circumstances in accordance with the relevant ethical requirements. In addition, relevant ethical requirements or law or regulation may also specify particular communications to those charged with governance in circumstances when breaches of independence requirements have been identified.⁶⁵

A79. If there has been a breach by a component auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot use the work of that component auditor.

A80. Serious concerns are those concerns that in the group auditor's professional judgment cannot be overcome. The group engagement partner may be able to overcome less than serious concerns about the component auditor's professional competency (for example, lack of industry-specific knowledge), or the fact that the component auditor does not operate in an environment that actively oversees auditors, by the group auditor being more involved in the work of the component auditor or by directly performing further audit procedures on the financial information of the component.

Engagement Performance (Ref: par. .30)

A81. Proposed QM SAS⁶⁶ requires the engagement partner to determine that the nature, timing, and extent of direction, supervision, and review is planned and performed in accordance with the firm's policies or procedures, professional standards, and applicable legal and regulatory requirements, and is responsive to the nature and circumstances of the audit engagement and the resources

⁶² Paragraph 26 of proposed QM SAS

⁶³ Paragraph A65 of proposed QM SAS

⁶⁴ Paragraph 17 of proposed QM SAS

⁶⁵ Paragraph A17 of AU-C section 260

⁶⁶ Paragraph 30 of proposed QM SAS

assigned or made available to the engagement team. For a group audit, the approach to direction, supervision, and review will generally include a combination of addressing the group auditor's firm policies or procedures and group audit engagement specific responses.

- A82.** For a group audit, particularly when the engagement team includes a large number of component auditors that may be located in multiple locations, the group engagement partner may assign the design or performance of procedures, tasks, or actions to other members of the engagement team to assist the group engagement partner in fulfilling the responsibility for the nature, timing, and extent of the direction and supervision of component auditors and the review of their work (see also paragraph .13).
- A83.** If component auditors are from a firm other than the group auditor's firm, the firm's policies or procedures may be different, or different actions may need to be taken, respectively, in relation to the nature, timing, and extent of direction and supervision of those members of the engagement team, and the review of their work. In particular, firm policies or procedures may require the firm or the group engagement partner to take different actions from those applicable to members of the engagement team within the firm or the network (for example, in relation to the form, content and timing of communications with component auditors, including the use of group auditor instructions to component auditors). Proposed QM SAS provides examples of actions that may need to be taken in such circumstances.⁶⁷
- A84.** The nature, timing, and extent of direction and supervision of component auditors and review of their work may be tailored based on the nature and circumstances of the engagement and, for example, the following factors:
- The assessed risks of material misstatement For example, if the group auditor has identified a component that includes a significant risk, an increase in the extent of direction and supervision of the component auditor and a more detailed review of the component auditor's audit documentation may be appropriate.
 - The competence and capabilities of the component auditors performing the audit work For example, if the group auditor has no previous experience working with a component auditor, the group auditor may communicate more detailed instructions, increase the frequency of discussions or other interactions with the component auditor, or assign more experienced individuals to oversee the component auditor as the work is performed.
 - The location of engagement team members, including the extent to which engagement team members are dispersed across multiple locations, including when service delivery centers are used
 - Access to component auditor audit documentation For example, when law or regulation precludes component auditor audit documentation from being transferred out of the component auditor's jurisdiction, the group auditor may be able to review the audit documentation at the component auditor's location or remotely through the use of technology, when not prohibited by law or regulation (see also paragraphs A216–A217)
- A85.** The following are examples of different ways in which the group engagement partner may take responsibility for directing and supervising component auditors and reviewing their work :
- Communications with component auditors throughout the course of the group audit, including communications required by this proposed SAS;
 - Meetings or calls with component auditors to discuss identified and assessed risks, findings

⁶⁷ Paragraphs A24-A25 of proposed QM SAS

or issues, and conclusions.

- Reviews of the component auditor's audit documentation in person or remotely when permitted by law and regulation.
- Participating in closing or other key meetings between the component auditors and component management.

A86. In applying proposed QM SAS,⁶⁸ the group engagement partner is required to review audit documentation at appropriate points in time during the audit engagement, including audit documentation relevant to the group audit relating to

- significant matters;
- significant judgments, including those relating to difficult or contentious matters identified during the audit engagement, and the conclusions reached; and
- other matters that, in the engagement partner's professional judgment, are relevant to the engagement partner's responsibilities.

The review of such audit documentation by the group engagement partner often takes place during the course of the group audit, including the review of relevant component auditor audit documentation (also see paragraph A162). The group engagement partner exercises professional judgment in determining the nature and extent of the review of component auditor audit documentation.⁶⁹ Such review may constitute reviewing component auditor communications.

Communications with Component Auditors (Ref: par. .31)

A87. Clear and timely communication between the group auditor and the component auditors about their respective responsibilities, along with clear direction to the component auditors about the nature, timing, and extent of the work to be performed and the matters expected to be communicated to the group auditor, helps establish the basis for effective two-way communication. Effective two-way communication between the group auditor and the component auditors also helps to set expectations for component auditors and facilitates the group auditor's direction and supervision of them and the review of their work. Such communication also provides an opportunity for the group engagement partner to reinforce the need for component auditors to maintain professional skepticism in the work performed for purposes of the group audit.

A88. The following are examples of other factors that may also contribute to effective two-way communication:

- Clarity of the instructions to the component auditor, particularly when the component auditor is from another firm and may not be familiar with the policies or procedures of the group auditor's firm
- A mutual understanding that the component auditor may discuss the audit work requested to be performed, based on the component auditor's knowledge and understanding of the component
- A mutual understanding of relevant issues and the expected actions arising from the communication process

⁶⁸ Paragraphs 31 and A92-A93 of proposed QM SAS

⁶⁹ Paragraph A91 of proposed QM SAS

- The form of communications. For example, matters that need timely attention may be more appropriately discussed in a meeting rather than by exchanging emails
- A mutual understanding of the person(s) from the group auditor and component auditors who have responsibility for managing communications regarding particular matters
- The process for the component auditor to take action and report back on matters communicated by the group auditor

A89. The communications between the group auditor and component auditors depend on the facts and circumstances of the group audit engagement, including the nature and extent of involvement of the component auditors and the degree to which the group auditor and component auditors are subject to common systems of quality management or common network requirements or network services.

Form of communications

A90. The form of the communications between the group auditor and component auditors may vary based on factors such as the nature of the audit work the component auditors have been requested to perform, and the extent to which communication capabilities are integrated into the audit tools used for the group audit.

A91. The form of communications also may be affected by such factors as the following:

- The significance, complexity, or urgency of the matter
- Whether the matter has been or is expected to be communicated to group management and those charged with governance of the group
- Whether the group auditor and component auditor are from the same firm or network firms

A92. Communication between the group auditor and the component auditor may not necessarily be in writing. However, the group auditor's verbal communications with the component auditors may be supplemented by written communication, such as a set of instructions regarding the work to be performed, when the group auditor wants to give particular attention to, or promote a mutual understanding about, certain matters. In addition, the group auditor may meet with the component auditor to discuss significant matters or to review relevant parts of the component auditor's audit documentation.

A93. Paragraph .47 requires the group auditor to request the component auditor to communicate matters relevant to the group auditor's conclusion with regard to the group audit. As explained in paragraph A160, the form and content of the component auditor's deliverables are influenced by the nature and extent of the audit work the component auditor has been requested to perform.

A94. Regardless of the form of communications between the group auditor and component auditors, the documentation requirements of this proposed SAS and other AU-C sections apply.

Timing of communications

A95. The appropriate timing of communications will vary with the circumstances of the engagement. Relevant circumstances may include the nature, timing, and extent of work to be performed by the component auditor and the action expected to be taken by the component auditor. For example, communications regarding planning matters may often be made early in the audit engagement and, for an initial group audit, may be made as part of agreeing the terms of the engagement.

Noncompliance with laws or regulations (Ref: par. .27, .31)

- A96.** In applying AU-C section 250,⁷⁰ the group engagement partner may become aware of information about noncompliance or suspected noncompliance with laws or regulations. In such circumstances, the group engagement partner may have an obligation under relevant ethical requirements, laws, or regulations, to communicate the matter to the component auditor.⁷¹

Understanding the Group and Its Environment, the Applicable Financial Reporting Framework, and the Group's System of Internal Control (Ref: par. .32)

- A97.** AU-C section 315⁷² contains requirements and guidance regarding the auditor's responsibility to obtain an understanding of the entity and its environment, the applicable financial reporting framework, and the entity's system of internal control. Appendix A, "Understanding the Group's System of Internal Control" of this proposed SAS provides examples of matters related to controls that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how AU-C section 315 is to be applied to an audit of group financial statements.

- A98.** The group auditor's understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control with respect to the components for which a referred-to auditor performs an audit may vary as compared to the components for which a component auditor performs audit procedures.

- A99.** The understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control may be obtained through communications with

- group management, component management, or other appropriate individuals within the entity, including individuals within the internal audit function (if the function exists) and individuals who have knowledge of the group's system of internal control, accounting policies and practices, and the consolidation process;
- component auditors or referred-to auditors; or
- auditors that perform an audit for legal, regulatory, or other reasons of the financial statements of an entity or business unit that is part of the group.

- A100.** Obtaining an understanding of the group, identifying risks of material misstatement, and assessing inherent risk and control risk may be performed in different ways depending on preferred audit techniques or methodologies and may be expressed in different ways. Accordingly, when component auditors are involved in the design and performance of risk assessment procedures, the group auditor may communicate its preferred approach with component auditors or provide instructions.

Engagement Team Discussion (Ref: par..32)

- A101.** In applying AU-C section 315,⁷³ the group engagement partner and other key engagement team members are required to discuss the application of the applicable financial reporting framework and the susceptibility of the group's financial statements to material misstatement. The group engagement partner's determination of which members of the engagement team to include in the discussion and the topics to be discussed, is affected by matters such as initial expectations about

⁷⁰ AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*

⁷¹ See, for example, paragraphs 22–23 of the proposed "Responding to Noncompliance With Laws and Regulations" interpretation of the AICPA Code of Professional Conduct

⁷² Paragraphs 19–31 and A58–A212 of AU-C section 315

⁷³ Paragraph 17 of AU-C section 315

the risks of material misstatement and the preliminary expectation of whether to involve component auditors.

A102. The discussion provides an opportunity to do the following:

- Share knowledge of the components and their environments, including which components' activities are centralized
- Exchange information about the business risks of the components or the group, and how inherent risk factors may affect susceptibility to misstatement of classes of transactions, account balances, and disclosures
- Exchange ideas about how and where the group financial statements may be susceptible to material misstatement due to fraud or error. AU-C section 240⁷⁴ requires the engagement team discussion to place particular emphasis on how and where the entity's financial statements may be susceptible to material misstatement due to fraud, including how fraud may occur
- Identify policies followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting
- Consider known external and internal factors affecting the group that may create an incentive or pressure for group management, component management, or others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables group management, component management, or others to rationalize committing fraud
- Consider the risk that group or component management may override controls
- Discuss fraud that has been identified, or information that indicates existence of a fraud
- Identify risks of material misstatement relevant to components where there may be impediments to the maintenance of professional skepticism
- Consider 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 accounting policies are identified and adjusted (when required by the applicable financial reporting framework)
- Share information about risks of material misstatement of the financial information of a component that may apply more broadly to some, or all, of the other components
- Share information that may indicate noncompliance with national laws or regulations, for example, payments of bribes and improper transfer pricing practices
- Discuss events or conditions identified by group management, component management, or the engagement team, that may raise substantial doubt about the group's ability to continue as a going concern for a reasonable period of time
- Discuss related party relationships or transactions identified by group management or component management, and any other related parties of which the engagement team is aware

⁷⁴ Paragraph 15 of AU-C section 240

The Group and Its Environment (Ref: par. .32a)

A103. An understanding of the group's organizational structure and its business model may enable the group auditor to understand such matters as the following:

- The complexity of the group's structure A group may be more complex than a single entity because a group may have several subsidiaries, divisions, or other business units, including in multiple locations. Also, a group's legal structure may be different from the operating structure, for example, for tax purposes. Complex structures often introduce factors that may give rise to increased susceptibility to material misstatements, such as whether goodwill, joint ventures, or variable interest entities are accounted for appropriately and whether adequate disclosures have been made.
- The geographic locations of the group's operations Having a group that is located in multiple geographical locations may give rise to increased susceptibility to material misstatements. For example, different geographical locations may involve different languages, cultures, and business practices.
- The structure and complexity of the group's IT environment A complex IT environment often introduces factors that may give rise to increased susceptibility to material misstatements. For example, a group may have a complex IT environment because of multiple IT systems that are not integrated due to recent acquisitions or mergers. Therefore, it may be particularly important to obtain an understanding of the complexity of the security over the IT environment, including vulnerability of the IT applications, databases, and other aspects of the IT environment. A group may also use one or more external service providers for aspects of its IT environment.
- Relevant regulatory factors, including the regulatory environment Different laws or regulations may introduce factors that may give rise to increased susceptibility to material misstatements. A group may have operations that are subject to a high degree of complex laws or regulations in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of laws or regulations.
- The ownership, and relationships between owners and other people or entities, including related parties Understanding the ownership and relationships can be more complex in a group that operates across multiple jurisdictions and when there are changes in ownership through formation, acquisition, disposal, or joint venture. These factors may give rise to increased susceptibility to material misstatements.

A104. Obtaining an understanding of the degree to which the group's operations or activities are similar may help to identify similar risks of material misstatement across components and design an appropriate response.

A105. The financial results of entities or business units are ordinarily measured and reviewed by group management. Inquiries of group management may reveal that group management relies on certain key indicators to evaluate the financial performance of the group's entities and business units and take action. The understanding of such performance measures may help to identify

- areas where there is increased susceptibility to material misstatements (for example, due to pressures on component management to meet certain performance measures).
- controls over the group's financial reporting process.

The Group's System of Internal Control

The Nature and Extent of Commonality of Controls (Ref: par. .32c(i))

- A106.** Group management may design controls that are intended to operate in a common manner across multiple entities or business units (i.e., common controls). For example, group management may design common controls for inventory management, which operate using the same IT system and that are implemented across all entities or business units in the group. Common controls may exist in each component of the group's system of internal control, and they may be implemented at different levels within the group (for example, at the level of the consolidated group as a whole, or for other levels of aggregation within the group). Common controls may be direct controls or indirect controls. Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level. Indirect controls are controls that support direct controls.⁷⁵
- A107.** Understanding the components of the group's system of internal control includes understanding the commonality of tasks and actions, structures, processes, or controls within those components across the group. In understanding the commonality of a control across the group, considerations that may be relevant include whether
- the control is designed centrally and is required to be implemented as designed (i.e., without modification) at some or all components;
 - the control is implemented and, if applicable, monitored by individuals with similar responsibilities and capabilities at all the components where the control is implemented;
 - if a control uses information from IT applications, the IT applications and other aspects of the IT environment that generate the information are the same across the components or locations; or
 - if the control is automated, it is configured in the same way in each IT application across the components.
- A108.** Judgment may often be needed to determine whether a control is a common control. For example, group management may require that all entities and business units perform a monthly evaluation of the aging of customers' accounts that are generated from a specific IT application. When the aging reports are generated from different IT applications or the implementation of the IT application differs across entities or business units, there may be a need to consider whether the control can be determined to be common. This is because of differences in the design of the control that may exist due to the existence of different IT applications (for example, whether the IT application is configured in the same manner across components, and whether there are effective general IT controls across different IT applications).
- A109.** Consideration of the level at which controls are performed within the group (for example, at the level of the consolidated group as a whole or for other levels of aggregation within the group) and the degree of centralization and commonality may be important to the understanding of how information is processed and controlled. In some circumstances, controls may be performed centrally (for example, performed only at a single entity or business unit), but may have a pervasive effect on other entities or business units (for example, a shared service center that processes transactions on behalf of other entities or business units within the group). The processing of transactions and related controls at a shared service center may operate in the same way for those transactions being processed by the shared service center regardless of the entity or business unit (for example, the processes, risks of material misstatement, and controls may be the same regardless of the source of the transaction). In such cases, it may be appropriate to identify the controls and evaluate the design and determine the implementation of the controls, and, if applicable, test operating effectiveness, as a single population.

⁷⁵ Paragraph A5 of AU-C section 315

Centralized Activities (Ref: par. .32c(i)–(ii))

- A110.** Group management may centralize some of its activities, for example financial reporting or accounting functions may be performed for a particular group of common transactions or other financial information in a consistent and centralized manner for multiple entities or business units (for example, when the initiation, authorization, recording, processing, or reporting of revenue transactions is performed at a shared service center).
- A111.** Obtaining an understanding of how centralized activities fit into the overall group structure, and the nature of the activities undertaken, may help to identify and assess risks of material misstatement and appropriately respond to such risks. For example, controls at a shared service center may operate independently from other controls, or they may be dependent upon controls at an entity or business unit from which financial information is derived (for example, sales transactions may be initiated and authorized at an entity or business unit, but the processing may occur at the shared service center).
- A112.** The group auditor may involve component auditors in testing the operating effectiveness of common controls or controls related to centralized activities. In such circumstances, effective collaboration between the group auditor and component auditors is important as the audit evidence obtained through testing the operating effectiveness of common controls or controls related to centralized activities supports the determination of the nature, timing, and extent of substantive procedures to be performed across the group.

Communications About Significant Matters that Support the Preparation of the Group Financial Statements (Ref: par. .32c(iv))

- A113.** Entities or business units may use a financial reporting framework for legal, regulatory, or other reasons that is different from the financial reporting framework used for the group's financial statements. In such circumstances, an understanding of group management's financial reporting processes to align accounting policies and, when relevant, financial reporting period-ends that differ from that of the group, enables the group auditor to understand how adjustments, reconciliations, and reclassifications are made, and whether they are made centrally by group management or by the entity or business unit.

Instructions by group management to entities or business units

- A114.** In applying AU-C section 315,⁷⁶ the group auditor is required to understand how group management communicates significant matters that support the preparation of the group financial statements. To achieve uniformity and comparability of financial information, group management may issue instructions (for example, 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. Obtaining an understanding of group management's instructions may affect the identification and assessment of the risks of material misstatement of the group financial statements. For example, inadequate instructions may increase the likelihood of misstatements due to the risk that transactions are incorrectly recorded or processed, or that accounting policies are incorrectly or inconsistently applied.
- A115.** The group auditor's understanding of the instructions or policies may include the following:
- The clarity and practicality of the instructions for completing the reporting package
 - Whether the instructions

⁷⁶ Paragraph 25(b) of AU-C section 315

- adequately describe the characteristics of the applicable financial reporting framework and the accounting policies to be applied;
- address information necessary to prepare disclosures that are sufficient to comply with the requirements of the applicable financial reporting framework, for example, disclosure of related party relationships and transactions, and segment information;
- address information necessary for making consolidation adjustments, for example, intra-group transactions and unrealized profits, and intra-group account balances; and
- include a reporting timetable.

Considerations When Component Auditors Are Involved (Ref: par. .33.34, .43)

A116. During the course of the group audit, the group auditor may communicate the matters in paragraph .33 to other component auditors, if these matters are relevant to the work of those component auditors. Paragraph A158 includes examples of other matters that may need to be communicated timely in the course of the component auditor's work.

A117. 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.⁷⁷ 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 when

- the group structure is complex;
- the group's information systems are not integrated and therefore less effective in identifying and recording related party relationships and transactions; and
- there are numerous or frequent related party transactions between entities and business units.

Planning and performing the audit with professional skepticism, as required by AU-C section 200,⁷⁸ is therefore particularly important when these circumstances exist.

A118. A component auditor may identify related party relationships or transactions that were not previously identified by group management or the group auditor. The group auditor is required by paragraph 33b to communicate to any other component auditors those related party relationships or transactions if they are relevant to the work of the other component auditors.

Identifying and Assessing the Risks of Material Misstatement (Ref: par. .35)

A119. The process to identify and assess the risks of material misstatement of the group financial statements is iterative and dynamic, and may be challenging, particularly when the component's activities are complex or specialized, or when there are many components across multiple locations. In applying AU-C section 315,⁷⁹ the auditor develops initial expectations about the potential risks of material misstatement and an initial identification of the significant classes of transactions, account balances, and disclosures of the group financial statements based on their understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control.

⁷⁷ Paragraph 3 of AU-C section 550

⁷⁸ Paragraph 17 of AU-C section 200

⁷⁹ Paragraph A143 of AU-C section 315

- A120.** The initial expectations about the potential risks of material misstatement take into account the auditor's understanding of the group, including its entities or business units, and the environments and industries in which they operate. Based on the initial expectations, the group auditor may, and often will, involve component auditors in risk assessment procedures as they may have direct knowledge and experience with the entities or business units that may be helpful in understanding the activities and related risks, and where risks of material misstatement of the group financial statements may arise in relation to those entities or business units.
- A121.** For identified risks of material misstatement at the assertion level, the group auditor is required to take responsibility for assessing inherent risk. Such assessment involves assessing the likelihood and magnitude of misstatement, which takes into account how, and the degree to which⁸⁰
- inherent risk factors affect the susceptibility of relevant assertions to misstatement.
 - the risks of material misstatement at the group financial statement level affect the assessment of inherent risk for risks of material misstatement at the assertion level.
- A122.** Based on the risk assessment procedures performed, the group auditor may determine that an assessed risk of material misstatement of the group financial statements only arises in relation to financial information of certain components. For example, the risk of material misstatement relating to a legal claim may only exist in entities or business units that operate in a certain jurisdiction or in entities or business units that have similar operations or activities.
- A123.** Appendix B, "Examples of Events or Conditions that May Give Rise to Risks of Material Misstatement of the Group Financial Statements," of this proposed SAS sets out examples of events and conditions that, individually or together, may indicate risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process.

Fraud

- A124.** In applying AU-C section 240,⁸¹ 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 and assess the risks of material misstatement of the group financial statements due to fraud may include the following:
- Group management's assessment of the risk that the group financial statements may be materially misstated due to fraud
 - Group management's process for identifying and responding to the risks of fraud in the group financial statements, including any specific fraud risks identified by group management, or classes of transactions, account balances, or disclosures for which a risk of fraud is higher
 - 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

⁸⁰ Paragraph 35 of AU-C section 315

⁸¹ Paragraphs 26 and 31 of AU-C section 240

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, group management, appropriate individuals within the internal audit function (and when appropriate, component management, the component auditors, and others) to the group auditor's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group

Considerations When Component Auditors Are Involved (Ref: par. .3636)

- A125.** When the group auditor involves component auditors in the design and performance of risk assessment procedures, the group auditor remains responsible for having an understanding of the group and its environment, the applicable financial reporting framework, and the group's system of internal control to have a sufficient basis for the identification and assessment of the risks of material misstatement of the group financial statements in accordance with paragraph .3535.
- A126.** When the audit evidence obtained from the risk assessment procedures does not provide an appropriate basis for the identification and assessment of the risks of material misstatement, AU-C section 315⁸² requires the auditor to perform additional risk assessment procedures until audit evidence has been obtained to provide such a basis.

Materiality

Component Performance Materiality (Ref: par. .37a)

- A127.** Paragraph .37a requires the group auditor to determine component performance materiality for each of the components where the group auditor or component auditor will perform audit procedures on financial information that is disaggregated. 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.
- A128.** This proposed SAS does not require component performance materiality to be determined for components that are audited by referred-to auditors and for which the group auditor plans to make reference to the audit of the referred-to auditor in the auditor's report on the group financial statements.
- A129.** This proposed SAS 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, AU-C section 320⁸³ 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 group auditor may need to consider whether a component performance materiality lower than the amount communicated to the component auditor may be appropriate for those particular classes of transactions, account balances, or disclosures.⁸⁴
- A130.** The determination of component performance materiality is not a simple mechanical calculation

⁸² Paragraph 39 of AU-C section 315

⁸³ Paragraphs 10 and A13-A14 of AU-C section 320

⁸⁴ Paragraph A15 of AU-C section 320

and involves the exercise of professional judgment. Factors the group auditor may take into account in setting component performance materiality include the following:

- The extent of disaggregation of the financial information across components (for example, 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 (for example, 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,
 - whether there are risks that are unique to the financial information of the component (for example, industry-specific accounting matters, unusual or complex transactions).
 - the nature and extent of misstatements identified at the component in prior audits.

A131. To address aggregation risk, paragraph .37a requires component performance materiality to be lower than group performance materiality. As explained in paragraph A130, 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. When determining component performance materiality for a non-controlling interest in an entity that is accounted for by the equity method, the group auditor may take into account the group's ownership percentage and the share of the investee's profits and losses.

A132. In some cases, further audit procedures may be performed by the group auditor or a component auditor on a significant class of transactions or significant account balance as a single population (i.e., not disaggregated across components). In such cases, group performance materiality often will be used for purposes of performing these procedures.

A133. When the component is subject to an audit required by law or regulation or performed for another reason, the performance materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group performance materiality and, accordingly, the lower component performance materiality would be acceptable for purposes of the group audit.

'Clearly Trivial' Threshold (Ref: par. .37b)

A134. The threshold for communicating misstatements to the group auditor is set at an amount equal to, or lower than, the amount regarded as clearly trivial for the group financial statements. In accordance with AU-C section 450,⁸⁵ this threshold is the amount below which misstatements would not need to be accumulated because the group auditor expects that the accumulation of such amounts clearly would not have a material effect on the group financial statements.

Considerations When Component Auditors Are Involved

Communicating Component Performance Materiality (Ref: par. .38)

A135. In some cases, it may be appropriate for the group auditor to involve the component auditor in

⁸⁵ Paragraph A3 of AU-C section 450

determining an appropriate component performance materiality amount, in view of the component auditor's knowledge of the component and potential sources of misstatement of the component financial information. In this regard, the group auditor also may consider communicating group performance materiality to the component auditor to support collaboration in determining whether component performance materiality, in relation to group performance materiality, is appropriate in the circumstances.

- A136.** Component performance materiality is based, at least in part, on expectations about the nature, frequency, and magnitude of misstatements in the component financial information. Therefore, ongoing communication between the component auditor and the group auditor is important, particularly if the number and magnitude of misstatements identified by the component auditor are higher than expected.

Responding to the Assessed Risks of Material Misstatement (Ref: par. .39)

Performing Further Audit Procedures

Performing Further Audit Procedures Centrally

- A137.** 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 (e.g., at a shared service center). Factors that may be relevant to the auditor's determination of whether to perform further audit procedures centrally include, for example:

- the level of centralization of activities relevant to financial reporting
- the nature and extent of commonality of controls.
- the similarity of the group's activities and business lines.

- A138.** The group auditor may determine that the financial information of several components can be considered as one population for the purpose of performing further audit procedures, for example, when transactions are considered to be homogenous 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.

- A139.** When further audit procedures are performed centrally, component auditors may still be involved. For example, when the group has multiple shared service centers, the group auditor may involve component auditors in the performance of further audit procedures for these shared service centers.

Performing Further Audit Procedures at the Component Level

- A140.** In other circumstances, procedures to respond to the risks of material misstatement of the group financial statements that are related to the financial information of a component may be more effectively performed at the component level. This may be the case when the group has

- different revenue streams;
- multiple lines of business;
- operations across multiple locations; or

- decentralized systems of internal control.

Large Number of Components Whose Financial Information Is Individually Immaterial but Material in the Aggregate to the Group Financial Statements

- A141.** A group may be comprised of a large number of components whose financial information is individually immaterial but material in the aggregate to the group financial statements. Circumstances such as these in which the significant classes of transactions, account balances, or disclosures in the group financial statements are disaggregated over a large number of components may present additional challenges for the group auditor in planning and performing further audit procedures.
- A142.** In some cases, it may be possible to obtain sufficient appropriate audit evidence by performing further audit procedures centrally on these significant classes of transactions, account balances, or disclosures (for example, if they are homogeneous, subject to common controls and access to appropriate information can be obtained). The further audit procedures may also include substantive analytical procedures in accordance with AU-C section 520.⁸⁶ Depending on the circumstances of the engagement, the financial information of the components may be aggregated at appropriate levels for purposes of developing expectations and determining the amount of any difference of recorded amounts from expected values in performing the substantive analytical procedures. The use of automated tools and techniques may be helpful in these circumstances.
- A143.** In other cases, it may be necessary to perform further audit procedures at selected components to address the risks of material misstatement of the group financial statements. The determination of the components at which audit procedures are to be performed, and the nature, timing, and extent of further audit procedures to be performed at the selected components, are matters of professional judgment. In these circumstances, introducing an element of unpredictability in the components selected for testing also may be helpful in relation to the risks of material misstatement of the group financial statements due to fraud (also see paragraph A150).

The Nature and Extent of Further Audit Procedures

- A144.** In response to the assessed risks of material misstatement, the group auditor may determine the following scope of work to be appropriate at a component (with the involvement of component auditors, as applicable):
- 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
 - Perform specific further audit procedures
- A145.** Although the group auditor takes responsibility for the nature, timing, and extent of further audit procedures to be performed, component auditors can be, and often are, involved in all phases of the group audit, including in the design and performance of further audit procedures.
- A146.** The group auditor may determine that obtaining the audit report of a referred-to auditor with respect to one or more components may be appropriate audit evidence. In that case, the group auditor follows the requirements in this proposed SAS when making reference to the audit of the referred-

⁸⁶ AU-C section 520, *Analytical Procedures*

to auditor in the auditor's report on the group financial statements.

Design and Perform Further Audit Procedures on the Entire Financial Information of the Component

A147. The group auditor may determine that designing and performing further audit procedures on the entire financial information of a component is an appropriate approach, including when

- audit evidence needs to be obtained on all or a significant proportion of a component's financial information to respond to the assessed risks of material misstatement of the group financial statements.
- there is a pervasive risk of material misstatement of the group financial statements due to the existence of events or conditions at the component that may be relevant to the group auditor's evaluation of group management's assessment of the group's ability to continue as a going concern for a reasonable period of time.

Design and perform further audit procedures on one or more classes of transactions, account balances, or disclosures

A148. The group auditor may determine that designing and performing further audit procedures on one or more particular classes of transactions, account balances, or disclosures of the financial information of a component is an appropriate approach to address assessed risks of material misstatement of the group financial statements. For example, a component may have limited operations but holds a significant portion of the land and buildings of the group or has significant tax balances.

Perform specific further audit procedures

A149. The group auditor may determine that designing and performing specific further audit procedures on the financial information of a component is an appropriate approach, such as when audit evidence needs to be obtained for one or more relevant assertions only. For example, the group auditor may centrally test the class of transaction, account balance or disclosure and may require the component auditor to perform specific further audit procedures at the component (for example, specific further audit procedures related to the valuation of claims or litigations in the component's jurisdiction or the existence of an asset).

Element of Unpredictability

A150. Incorporating an element of unpredictability in the type of work to be performed, the entities or business units at which procedures are performed and the extent to which the group auditor is involved in the work, may increase the likelihood of identifying a material misstatement of the components' financial information that may give rise to a material misstatement of the group financial statements due to fraud.⁸⁷

Operating Effectiveness of Controls

A151. The group auditor may rely on the operating effectiveness of controls that operate throughout the group in determining the nature, timing, and extent of substantive procedures to be performed at either the group level or at the components. AU-C section 330⁸⁸ requires the auditor to design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of those controls. Component auditors may be involved in designing and performing such tests of controls.

⁸⁷ Paragraph 29c of AU-C section 240

⁸⁸ Paragraph 8 of AU-C section 330

A152. If deviations from controls upon which the auditor intends to rely are detected, AU-C section 330⁸⁹ requires the auditor to make specific inquiries to understand these matters and their potential consequences. If more deviations than expected are detected as a result of testing the operating effectiveness of the controls, the group auditor may need to revise the group audit plan. Possible revisions to the group audit plan may include the following:

- Performing additional substantive procedures at certain components
- Identifying and testing the operating effectiveness of other relevant controls that are designed and implemented effectively
- Increasing the number of components selected for further audit procedures

A153. When the operating effectiveness of controls is tested centrally (for example, controls at a shared service center or testing of common controls), the group auditor may need to communicate information about the audit work performed to the component auditors. For example, when a component auditor is requested to design and perform substantive procedures on the entire financial information of the component, or design and perform substantive procedures on one or more classes of transactions, account balances, or disclosures, the component auditor may discuss with the group auditor about the control testing performed centrally to determine the nature, timing, and extent of the substantive procedures.

Consolidation Process

Consolidation Procedures (Ref: par. .40a)

A154. The further audit procedures on the consolidation, including sub consolidations, may include

- determining that the necessary journal entries are reflected in the consolidation; and
- evaluating the operating effectiveness of the controls over the consolidation process and responding appropriately if any controls are determined to be ineffective.

Consolidation Adjustments and Reclassifications (Ref: par. .40b)

A155. The consolidation process may require adjustments and reclassifications to amounts reported in the group financial statements⁹⁰ 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 group auditor's evaluation of the appropriateness, completeness, and accuracy of the adjustments and reclassifications may include the following:

- 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

⁸⁹ Paragraph 17 of AU-C section 330

⁹⁰ Paragraph 21b of AU-C section 330

documented

- Evaluating the reconciliation and elimination of intra-group transactions, unrealized profits or losses, and intra-group account balances

Considerations When Component Auditors Are Involved (Ref: par. .44–.45)

A156. When the group auditor involves component auditors in the design or performance of further audit procedures, the component auditor may determine that the use of the work of an auditor's specialist is appropriate and communicate this to the group auditor. In such circumstances, when determining whether the component auditor's design and performance of further audit procedures is appropriate, the group auditor may, for example, discuss the following with the component auditor:

- The nature, scope, and objectives of the auditor's specialist's work
- The component auditor's evaluation of the adequacy of the work of the auditor's specialist for the group auditor's purposes

A157. The appropriate level of the group auditor's involvement may depend on the circumstances and the structure of the group and other factors, such as the group auditor's previous experience with the component auditors that perform procedures on the consolidation and sub-consolidations and the circumstances of the group audit engagement (for example, if the financial information of an entity or business unit has not been prepared in accordance with the same accounting policies applied to the group financial statements).

Evaluating the Component Auditor's Communication and the Adequacy of Their Work

Communication about Matters Relevant to the Group Auditor's Conclusion with Regard to the Group Audit (Ref: par. .47)

A158. Although the matters required to be communicated in accordance with paragraph .4747 are relevant to the group auditor's conclusion with regard to the group audit, certain matters may be communicated during the course of the component auditor's procedures. In addition to the matters in paragraphs .34 and .67, such matters may include, for example:

- information about breaches of relevant ethical requirements, including identified breaches of independence provisions;
- information about instances of noncompliance with laws or regulations;
- newly arising significant risks of material misstatement, including risks of fraud;
- actual, suspected, or alleged fraud involving component management or employees that could have a material effect on the group financial statements;
- significant or unusual transactions; or
- differences of opinion that arise within the component auditor or between the component auditor and the component engagement quality reviewer.

Communication of Misstatements of Component Financial Information (Ref: par. .47e)

A159. Knowledge about corrected and uncorrected misstatements across components may alert the group auditor to potential pervasive control deficiencies, when considered along with the communication of deficiencies in accordance with paragraph .47g. In addition, a higher-than-

expected number of identified misstatements (uncorrected or corrected) may indicate a higher risk of undetected misstatements, which may lead the group auditor to conclude that additional audit procedures need to be performed at certain components.

Component Auditor's Overall Findings or Conclusions (Ref: par. .47k)

A160. The form and content of the deliverables from the component auditor are influenced by the nature and extent of the audit work the component auditor has been requested to perform. The group auditor's firm policies or procedures may address the form or specific wording of an overall conclusion from the component auditor on the audit work performed for purposes of the group audit.

Evaluating Whether Communications with the Component Auditor Are Adequate for the Group Auditor's Purposes (Ref: par. .48b)

A161. If the group auditor determines that the component auditor's communications are not adequate for the group auditor's purposes, the group auditor may consider whether, for example,

- further information can be obtained from the component auditor (for example, through further discussions or meetings);
- it is necessary to review additional component auditor audit documentation in accordance with paragraph .4949;
- additional audit procedures may need to be performed in accordance with paragraph .50.50;
- there are any concerns about the component auditor's competence or capabilities.

Reviewing Additional Component Auditor Audit Documentation (Ref: par. .49)

A162. Paragraph A84 provides guidance for the group auditor in tailoring the nature, timing, and extent of the direction and supervision of the component auditor, and the review of their work, based on the facts and circumstances of the group audit and other matters (for example, the assessed risks of material misstatement of the group financial statements). The group auditor's consideration in accordance with paragraph .49c also may be affected by the following matters relevant to the group auditor's ongoing involvement in the work of the component auditor:

- Communications from the component auditor, including those in accordance with paragraph .47 of this proposed SAS
- The review of component auditor audit documentation by the group auditor during the course of the group audit (for example, to fulfill the requirements of paragraphs .36, .44 and .45) or by the group engagement partner in accordance with paragraph 31 of proposed QM SAS

A163. Other factors that may affect the group auditor's determination about whether, and the extent to which, it is necessary to review additional component auditor audit documentation in the circumstances include

- the degree to which the component auditor was involved in risk assessment procedures and in the identification and assessment of the risks of material misstatement of the group financial statements;
- the significant judgments made by, and the findings or conclusions of, the component auditor about matters that are material to the group financial statements;

- the competence and capabilities of more experienced engagement team members from the component auditor responsible for reviewing the work of less experienced individuals; and
- whether the component auditor and group auditor are subject to common policies or procedures for review of audit documentation.

Additional Procedures When Making Reference to the Audit of a Referred-to Auditor in the Auditor's Report on the Group Financial Statements

A164. The requirements in paragraphs .51–.65 and the related application material in paragraphs A165–A184 apply only when the group engagement partner plans to obtain audit evidence through making reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. (Ref: Exhibit A, "Relevancy of Requirements in Various Group Audit Scenarios.")

Understanding the Referred-to Auditor

Relevant Ethical Requirements, Including Those Related to Independence, for Referred-To Auditors (Ref: par. .51)

A165. When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, the referred-to auditor is subject to ethical requirements, including those related to independence, that are relevant to the group audit. Such requirements may be different or in addition to those applying to a referred-to auditor when performing an audit on the financial statements of an entity or business unit that is part of the group for legal, regulatory, or other reasons in the referred-to auditor's jurisdiction. When the referred-to auditor is not subject to the *AICPA Code of Professional Conduct*, compliance by the referred-to auditor with the ethics and independence requirements set forth in the *International Federation of Accountants Code of Ethics for Professional Accountants* is sufficient to fulfill the referred-to auditor's ethical responsibilities in the group audit.

Competence and Capabilities of Referred-To Auditors (Ref: par. .52.53)

A166. Determining whether referred-to auditors have the appropriate competence and capabilities is a matter of professional judgment and is influenced by the nature and circumstances of the group audit engagement.

A167. In determining whether referred-to auditors have the appropriate competence and capabilities, the group engagement partner may consider matters such as the following:

- Previous experience with or knowledge of the referred-to auditor
- The referred-to auditor's specialized skills (for example, industry specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies)
- The referred-to auditor's understanding of the auditing and other standards applicable to the group audit that is sufficient to fulfill the referred-to auditor's responsibilities
- Whether a referred-to auditor operates in a regulatory environment that actively oversees auditors

A168. The procedures to determine the referred-to auditor's competency and capability may include, for example, the following:

- Requesting the referred-to auditor to confirm the matter referred to in paragraph .52 in writing
- Obtaining published external inspection reports, peer review reports on the referred-to auditor's firm, and other relevant publicly available information relating to the professional reputation and standing of a referred-to auditor

A169. If there has been a breach by a referred-to auditor of the relevant ethical requirements that apply to the group audit engagement, including those related to independence, and the breach has not been satisfactorily addressed in accordance with provisions of the relevant ethical requirements, the group auditor cannot make reference in the auditor's report on the group financial statements to the audit of the referred-to auditor. The group auditor also cannot use the work of that auditor in the capacity of a component auditor as described by this proposed SAS.

A170. Serious concerns are those concerns that in the group auditor's professional judgment cannot be overcome. The group engagement partner may be able to overcome less than serious concerns about the referred-to auditor's professional competency or the fact that the referred-to auditor does not operate in an environment that actively oversees auditors, by, for example, the group auditor directly performing further audit procedures on the financial information of the component.

Determining Whether to Make Reference to the Audit of a Referred-To Auditor (Ref: par. .55–.56)

A171. The group engagement partner determines, individually for each component, whether to

- be involved in the work of the component auditor, insofar as that work relates to the expression of an audit opinion on the group financial statements, or
- make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.

A172. In group audits with two or more components, the decision to make reference is made individually for each potential referred-to auditor. The group auditor may make reference to any, all, or none of the potential referred-to auditors. For example, if one component is audited by an auditor from a network firm and another component is audited by a non-network firm, the group engagement partner may decide to be involved in the work of the auditor from the network firm and to make reference to the work of the auditor from the non-network firm.

A173. The determination of whether to be involved in the work of the component auditor or make reference to the audit of a referred-to auditor may include factors related to the group being audited or factors related to the performance of audit procedures for the group audit. Factors that may affect the group engagement partner's determination of whether to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the following:

- The group auditor's understanding of the group and its environment and the group's system of internal control
- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable
- Differences in the auditing and other standards applied by the potential referred-to auditor and those applied in the audit of the group financial statements

- Whether it is impracticable for the group auditor to be involved in the audit of the component financial statements

Determining Whether the Audit of the Referred-To Auditor Was Conducted in Accordance With GAAS (Ref. par. .56a)

A174. An auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph .56a.⁹¹ When the auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph .56a, relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group auditor may provide the referred-to auditor with AU-C Appendix B, "Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards," that identifies substantive requirements of GAAS that are not requirements in the ISAs. The referred-to auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The communication requested of the referred-to auditor required by paragraphs .62–.63 may address whether the audit met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the referred-to auditor, may decide to make reference to the audit of that referred-to auditor in the auditor's report on the group financial statements.

Determining Whether to Make Reference to the Audit of a Referred-To Auditor When the Financial Reporting Framework is Not the Same (Ref. par. .57)

A175. When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group auditor is required by this proposed SAS to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the group auditor is involved in the audit of the component financial statements. In rare circumstances, however, the group engagement partner may conclude that the group auditor can reasonably expect to obtain sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to be involved in the audit of the component financial statements .

A176. The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and *International Financial Reporting Standard for Small and Medium-sized*

⁹¹ Paragraphs .44-.46 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*

Entities, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP.⁹²

A177. When the component prepares financial statements using a different financial reporting framework than that used by the group, additional considerations in determining whether it may be appropriate to make reference to the audit of a potential referred-to auditor in the auditor's report on the group financial statements include the

- effectiveness of controls related to financial reporting and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments.
- depth of the group auditor's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments.
- extent of the group auditor's knowledge of the financial reporting framework used to prepare the component financial statements.
- group auditor's ability to obtain information from group or component management that is relevant to the adjustments.
- need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments.

Considerations for Governmental Entities

A178. When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by the Governmental Accounting Standards Board and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs .57 and .59c are not relevant.

Making Reference to the Audit of a Referred-To Auditor (Ref. par. .59–.61)

A179. Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a referred-to auditor is not to be construed as a qualification of the opinion, but rather is intended to communicate (1) that the group auditor was not involved in the work of the referred-to auditor, and (2) the source of the audit evidence with respect to those components for which reference to the audit of referred-to auditors is made.

A180. The disclosure of the magnitude of the portion of the financial statements audited by a referred-to

⁹² Paragraph .06 of AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*

auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a referred-to auditor. When two or more referred-to auditors are referred to, the dollar amounts or the percentages covered by the referred-to auditors may be stated in the aggregate.

- A181.** Exhibit B contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements.
- A182.** If there is a modified opinion, emphasis-of-matter paragraph, other-matter paragraph, or going concern section in the referred-to auditor's report, but it does not affect the report on the group financial statements and the referred-to auditor's report is not presented, the group auditor need not make reference to those paragraphs or section in the auditor's report on the group financial statements. If the referred-to auditor's report is presented, the group auditor may make reference to those paragraphs or section and their disposition.

Communications With the Referred-to Auditor (Ref: par. .62–.65)

- A183.** The form of the communications between the group auditor and referred-to auditors may vary and may not necessarily be in writing. However, verbal communications between the group auditor and referred-to auditors may be supplemented by written communication, such as the group auditor obtaining written representations from the referred-to auditor confirming that the referred-to auditor has complied with the ethical requirements that are relevant to the group audit engagement, including independence, or communicating matters related to the referred-to auditor's competence and capabilities.
- A184.** The referred-to auditor may identify related party relationships or transactions that were not previously identified by group management or the group auditor. The group auditor is required by paragraph .62b to communicate to any other referred-to auditors those related party relationships or transactions if they are relevant to the work of the other referred-to auditors.

Subsequent Events (Ref: par. .66–.67)

- A185.** When component auditors are involved, the group auditor may
- request a component auditor to perform subsequent events procedures to assist the group auditor to identify events that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial statements.
 - perform procedures to cover the period between the date of communication of subsequent events by the component auditor and the date of the auditor's report on the group financial statements, if applicable.
- A186.** When the group engagement partner determines to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements, procedures designed to identify subsequent events between the date of the referred-to auditor's report and the date of the auditor's report on the group financial statements may include the following:
- Obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified
 - Requesting the referred-to auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements

- Requesting specific written representations from component management regarding subsequent events
- Reading available interim financial information of the component and making inquiries of group management
- Reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date
- Reading the subsequent year's capital and operating budgets
- Inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events

A187. In applying AU-C section 330, if the group auditor is unable to obtain sufficient appropriate audit evidence, including with regard to subsequent events that require adjustment of, or disclosure in, the group financial statements, the auditor is required to express a qualified opinion or disclaim an opinion on the financial statements⁹³.

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Sufficiency and Appropriateness of Audit Evidence (Ref: par. .68.)

A188. The audit of group financial statements is a cumulative and iterative process. As the group auditor performs planned audit procedures, the audit evidence obtained may cause the group auditor to modify the nature, timing, or extent of other planned audit procedures as information may come to the group auditor's attention that differs significantly from the information on which the risk assessment was based. For example,

- the misstatements identified at a component may need to be considered in relation to other components; or
- the group auditor may become aware of access restrictions to information or people at a component because of changes in the environment (e.g., war, civil unrest, or outbreaks of disease).

In such circumstances, the group auditor may need to reevaluate the planned audit procedures, based on the revised consideration of assessed risks for all or some of the significant classes of transactions, account balances, or disclosures and related relevant assertions.

A189. The evaluation required by paragraph .68 assists the group auditor in determining whether the overall group audit strategy and group audit plan developed to respond to the assessed risks of material misstatement of the group financial statements continues to be appropriate. The requirement in AU-C section 330⁹⁴ for the auditor, irrespective of the assessed risks of material misstatement, to design and perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure also may be helpful for purposes of this evaluation in the context of the group financial statements.

A190. The group auditor may consider the engagement team's maintenance of professional skepticism

⁹³ Paragraphs .08–.10 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*, address qualified, adverse, and disclaimer of opinions.

⁹⁴ Paragraph 18 of AU-C section 330

when evaluating the sufficiency and appropriateness of audit evidence obtained. For example, the group auditor may consider whether matters such as those described in paragraph A17 have inappropriately led the engagement team to:

- obtain audit evidence that is easier to access without giving appropriate consideration to its relevance and reliability;
- obtain less persuasive evidence than is necessary in the circumstances; or
- design and perform audit procedures in a manner that is biased towards obtaining evidence that is corroborative or excluding evidence that is contradictory.

A191. Proposed QM SAS⁹⁵ requires the engagement partner to determine, on or before the date of the auditor's report, through review of audit documentation and discussion with the engagement team, that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. Information that may be relevant to the group auditor's evaluation of the audit evidence obtained from the work performed by component auditors or through making reference to the audit of referred-to auditors in the auditor's report on the group financial statements depends on the facts and circumstances of the group audit, and may include

- the communications from the component auditors required by paragraph .47, including the overall findings or conclusions of the component auditors on the work performed for purposes of the group audit;
- other communications from the component auditors throughout the group audit, including those required by paragraph .34;
- the group auditor's direction and supervision of the component auditors, and review of their work, including, as applicable, the group auditor's review of additional component auditor audit documentation in accordance with paragraph .49;
- the referred-to auditor's report on the component's financial statements, including, as applicable, if the opinion of a referred-to auditor is modified or if that report includes an emphasis-of-matter paragraph, an other-matter paragraph, or a going concern section; and
- the communications from the referred-to auditors required by this proposed SAS

A192. In some circumstances, an overall summary memorandum describing the work performed and the results thereof may provide a basis on its own for the group auditor to conclude that the work performed and audit evidence obtained by the component auditor is sufficient for purposes of the group audit. This may be the case, for example, when the component auditor has been requested to perform specific further audit procedures as identified and communicated by the group auditor.

Evaluating the Effect on the Group Audit Opinion (Ref: par. .69)

A193. The group engagement partner's evaluation may include a consideration of whether corrected and uncorrected misstatements communicated by component auditors indicate a systemic issue (e.g., regarding transactions subject to common accounting policies or common controls) that may affect other components.

Auditor's Report

Considerations When Component Auditors Are Involved (Ref: par. .70)

⁹⁵ Paragraph 32 of proposed QM SAS

- A194.** When component auditors are involved in the group audit, no reference is made to the component auditor in the auditor's report on the group financial statements because to do so may cause a reader to misinterpret the degree of responsibility of the group auditor.
- A195.** When the group audit opinion is modified because the group auditor was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, the Basis for Qualified Opinion or Basis for Disclaimer of Opinion section in the auditor's report on the group financial statements describes the reasons for that inability. In some circumstances, [the group auditor may decide](#) a reference to a component auditor or referred-to auditor ~~may be~~ necessary to adequately describe the reasons for the modified opinion, for example, when the component auditor is unable to perform or complete the work requested on the component financial information due to circumstances beyond the control of component management.

Communication with Group Management and Those Charged with Governance of the Group

Communication with Group Management (Ref: par. .71–.73)

- A196.** The group audit may be complex due to the number and nature of the entities and business units comprising the group. In addition, as explained in paragraph A7, the group auditor may determine that certain entities or business units may be considered together as a component for purposes of planning and performing the group audit. Therefore, discussing with group management an overview of the planned scope and timing may help in coordinating the work performed at components, including when component auditors are involved or reference is made to the audit of referred-to auditors in the auditor's report on the group financial statements, and in identifying component management (see paragraph A27).
- A197.** AU-C section 240⁹⁶ contains requirements and guidance on the communication of fraud to management and, when management may be involved in the fraud, to those charged with governance.
- A198.** Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements of the component of which component management may be unaware include the following:
- Potential litigation
 - Plans for abandonment of material operating assets
 - Subsequent events
 - Significant legal agreements
- A199.** Group management may inform the group auditor about noncompliance or suspected noncompliance with laws or regulations in entities or business units within the group. Paragraph A96 provides guidance for the group engagement partner in these circumstances.

Communication with Those Charged with Governance of the Group (Ref: par. .74)

- A200.** The matters the group auditor communicates to those charged with governance of the group may include those brought to the attention of the group auditor by component auditors or referred-to auditors that the group auditor judges to be significant to the responsibilities of those charged with

⁹⁶ Paragraphs 40-42 of -AU-C section 240

governance of the group. Communication with those charged with governance of the group may take place at various times during the group audit. For example, the matter referred to in paragraph .74a may be communicated after the group auditor has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph .74b may be communicated at the end of the audit, and the matters referred to in paragraph .74c–d may be communicated when they occur.

A201. AU-C section 260⁹⁷ requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. For a group audit, this communication helps those charged with governance understand the group auditor's determination of the components at which audit work will be performed, including whether certain of the group's entities or business units will be considered together as a component, the planned involvement of component auditors, and the basis for the decision to make reference to the audit of a referred-to auditor in the auditor's report on the group financial statements. This communication also helps to enable a mutual understanding of and discussion about the group and its environment (see paragraph .32) and areas, if any, in which those charged with governance may request the group auditor to undertake additional procedures.

Communication of Identified Deficiencies in Internal Control (Ref: par. .75)

A202. The group auditor is responsible for determining, on the basis of the audit work performed, whether one or more identified deficiencies, individually or in combination, constitute significant deficiencies or material weaknesses.⁹⁸ The group auditor may request input from the component auditor about whether an identified deficiency or combination of deficiencies at the component is a significant deficiency or material weakness in internal control.

Documentation (Ref: par. .76)

A203. Other AU-C sections contain specific documentation requirements that are intended to clarify the application of AU-C section 230 in the particular circumstances of those other AU-C sections. The Appendix to AU-C section 230 lists other AU-C sections that contain specific documentation requirements and guidance.

A204. The audit documentation for the group audit supports the group auditor's evaluation in accordance with paragraph .68 as to whether sufficient appropriate audit evidence has been obtained on which to base the group audit opinion. Also see paragraph A191.

A205. The audit documentation for the group audit comprises

- the documentation in the group auditor's file; and
- the separate documentation in the respective component auditor files relating to the work performed by the component auditors for purposes of the group audit (i.e., component auditor audit documentation).

A206. The final assembly and retention of the audit documentation for a group audit is subject to the policies or procedures of the group auditor's firm in accordance with proposed SQMS 1.⁹⁹ The group auditor may provide specific instructions to component auditors regarding the assembly and retention of the documentation of work performed by them for purposes of the group audit.

Basis for the Group Auditor's Determination of Components (Ref: par. .76b)

⁹⁷ Paragraph 11 of AU-C section 260

⁹⁸ Paragraph 9 of AU-C section 265

⁹⁹ Paragraphs 32(f) and A87-A89 of proposed SQMS 1

A207. The basis for the group auditor's determination of components may be documented in various ways, including, for example, documentation related to the fulfillment of the requirements in paragraphs .24, .35, and .74a of this proposed SAS.

Basis for the Group Auditor's Determination of the Competence and Capabilities of Component Auditors
(Ref: par: .76d)

A208. Proposed SQMS 1¹⁰⁰ provides guidance on matters that the firm's policies or procedures may address regarding the competence and capabilities of the engagement team members. Such policies or procedures may describe or provide guidance about how to document the determination of the competence and capabilities of the engagement team, including component auditors. For example, the confirmation obtained from the component auditor in accordance with paragraph .26 may include information about the component auditor's relevant industry experience. The group auditor also may ask for confirmation that the component auditor has sufficient time to perform the assigned audit procedures (see paragraph A71).

Documentation of the Direction and Supervision of Component Auditors and the Review of Their Work (Ref: Par. .76f)

A209. As described in paragraph A84, the approach to direction, supervision, and review in a group audit will be tailored by the group auditor based on the facts and circumstances of the engagement, and will generally include a combination of addressing the group auditor's firm policies or procedures and responses specific to the group audit. Such policies or procedures may also describe or provide guidance about the documentation of the group auditor's direction and supervision of the engagement team and the review of their work.

A210. AU-C section 300¹⁰¹ requires the auditor to develop an audit plan that includes a description of the nature, timing, and extent of the planned direction and supervision of engagement team members and the review of their work. When component auditors are involved, the extent of such descriptions will often vary by component, recognizing that the planned nature, timing, and extent of direction and supervision of component auditors, and review of their work, may be influenced by the matters described in paragraph A59.

A211. The group auditor's documentation of the direction and supervision of component auditors and the review of their work may include, for example, the following:

- Required communications with component auditors, including any instructions issued and other confirmations required by this proposed SAS
- The rationale for the selection of visits to component auditor sites, attendees at meetings and the nature of the matters discussed
- Matters discussed in meetings with component auditors or component management
- The rationale for the group auditor's determination of component auditor audit documentation selected for review
- Changes in the planned nature and extent of involvement with component auditors, and the reasons why This may include circumstances in which the group auditor modified the nature, timing, or extent of the direction and supervision of the component auditors, and the review of their work, in areas of the audit that are more complex or subjective than initially anticipated.

¹⁰⁰ Paragraph A100 of proposed SQMS 1

¹⁰¹ Paragraph 9 of AU-C section 300

- A212.** Paragraph .49 requires the group auditor to determine whether, and the extent to which it is necessary to review additional component auditor audit documentation. Paragraphs A162–A163 provide guidance for the group auditor in making this determination.
- A213.** Component auditor audit documentation ordinarily need not be replicated in the group auditor’s audit file. However, the group auditor may decide to summarize, replicate, or retain copies of certain component auditor documentation in the group auditor’s audit file to supplement the description of a particular matter in communications from the component auditor, including the matters required to be communicated by this proposed SAS. Examples of such component auditor documentation may include:
- a listing or summary of the significant judgments made by the component auditor, and the conclusions reached thereon, that are relevant to the group audit;
 - matters that may need to be communicated to those charged with governance of the group; or
 - matters that may be determined to be key audit matters to be communicated in the auditor’s report on the group financial statements, when engaged to do so.
- A214.** When required by law or regulation, certain component auditor documentation may need to be included in the group auditor’s audit file, for example, to respond to the request of a regulatory authority to review documentation related to work performed by a component auditor.
- A215.** Policies or procedures established by the firm in accordance with the firm’s system of quality management, or resources provided by the firm or a network, may assist the group auditor in documenting the direction and supervision of component auditors and the review of their work. For example, an electronic audit tool may be used to facilitate communications between the group auditor and component auditors. The electronic audit tool also may be used for audit documentation, including providing information about the reviewer(s) and the date(s) and extent of their review.

Additional Considerations When Access to Component Auditor Audit Documentation is Restricted (Ref. par. 59)

- A216.** Audit documentation for a group audit may present some additional complexities or challenges in certain circumstances. This may be the case, for example, when law or regulation restrict the component auditor from providing documentation outside of its jurisdiction, or when war, civil unrest or outbreaks of disease restrict access to relevant component auditor audit documentation.
- A217.** The group auditor may be able to overcome such restrictions by, for example,
- visiting the location of the component auditor, or meeting with the component auditor in a location different from where the component auditor is located, to review the component auditor’s audit documentation;
 - reviewing the relevant audit documentation remotely through the use of technology, when not prohibited by law or regulation;
 - requesting the component auditor to prepare and provide a memorandum that addresses the relevant information and holding discussions with the component auditor, if necessary, to discuss the contents of the memorandum; or
 - discussing with the component auditor the procedures performed, the evidence obtained

and the conclusions reached by the component auditor.

It is a matter of professional judgment whether one or more of the actions described above may be sufficient to overcome the restrictions depending on the facts and circumstances of the group audit.

- A218.** When access to component auditor audit documentation is restricted, the group auditor's documentation nonetheless needs to comply with the requirements of GAAS, including those relating to the documentation of the nature, timing, and extent of the group auditor's direction and supervision of component auditors and the review of their work. The guidance in paragraphs A162–A163 may be helpful in determining the extent of the group auditor's review of the component auditor audit documentation in these circumstances. Paragraphs A213 and A214 provide examples of circumstances in which certain component auditor audit documentation may be included in the group auditor's audit file.
- A219.** If the group auditor is unable to overcome restrictions on access to the component auditor audit documentation, the group auditor may need to consider whether a scope limitation exists that may require a modification to the opinion on the group financial statements. See paragraph A52.

A220.

Exhibit A: Relevancy of Requirements in Various Group Audit Scenarios

(Ref: par..10 .58a, A164)

The requirements of this proposed SAS are intended to be applied in the context of the nature and circumstances of each group audit. There are various scenarios, described below, related to how a group audit may be carried out. Depending on the involvement of component auditors or whether reference is made to the audit of a referred-to auditor in the auditor's report on the group financial statements, certain requirements in this proposed SAS may not be relevant due to their conditionality. The table below provides examples of the requirements in this proposed SAS that are relevant for various group audit scenarios.

Regardless of the scenario, as required by paragraph .21 of AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, the group auditor is required to have an understanding of the entire text of this proposed SAS, including its application and other explanatory material, to understand its objectives and to apply its requirements properly.

Group Audit Scenario	Relevant Requirements
<p>Scenario 1 – Group Auditor <i>The group audit is carried out entirely by the group auditor.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–24 • Paragraph 32 • Paragraphs 35–37 • Paragraphs 39–42 • Paragraph 66 • Paragraphs 68–69 • Paragraphs 71–72 • Paragraphs 74–76
<p>Scenario 2 – Group Auditor and Component Auditors <i>Component auditors are involved in the group audit.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–50 • Paragraphs 66–76
<p>Scenario 3 – Group Auditor and Referred-to Auditors <i>The group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–24 • Paragraph 32 • Paragraphs 35–37 • Paragraphs 39–42 • Paragraphs 51–66 • Paragraphs 68–69 • Paragraphs 71–76
<p>Scenario 4 – Group Auditor, Component Auditors, and Referred-to Auditor <i>Component auditors are involved in the group</i></p>	<ul style="list-style-type: none"> • Paragraphs 12–76

Agenda Item 1B – Proposed Group Audits SAS (Clean Draft)

Group Audit Scenario	Relevant Requirements
<i>audit and the group auditor makes reference to the audit of a referred-to auditor in the auditor's report on the group financial statements.</i>	

A221.

Exhibit B: Illustrative Auditor's Reports on Group Financial Statements

(Ref: par. A52)

Illustration 1— Independent Auditor's Report With a Qualified Opinion When the Group Auditor Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Auditor's Opinion

Circumstances include the following

- Audit of a complete set of consolidated general purpose financial statements
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the consolidated financial statements in AU-C section 210, *Terms of Engagement*.
- The group auditor is unable to obtain sufficient appropriate audit evidence relating to a component accounted for by the equity method because the group auditor was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a referred-to auditor. In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive. Accordingly, the auditor's report contains a qualified opinion.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events considered in the aggregate that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570.
- The auditor has not been engaged to communicate key audit matters in accordance with AU-C section 701.¹
- The auditor has obtained all the other information prior to the date of the auditor's report and the qualified opinion on the consolidated financial statements also affects the other information included in the annual report.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Audit of the Consolidated Financial Statements²

Qualified Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries (the Group), which comprise the consolidated statement of financial position as of December 31, 20X1, and the related consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and the related notes to the consolidated financial statements.

¹ AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

² The sub-title, "Report on the Audit of the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title, "Report on Other Legal and Regulatory Requirements" is not applicable.

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion section of our report, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 20X1, and (of) its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinion

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____ and \$___ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$_____ and \$___, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are required to be independent of ABC Company and its subsidiaries and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [insert the time period set by the applicable financial reporting framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is

expressed.³

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information [for another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in AU-C section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports, ~~for when there is a qualified opinion due to limitation of scope on the consolidated financial statements also affects the other information included in the annual report.~~]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

Illustration 2 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With Generally Accepted Auditing Standards

Circumstances include the following:

- Audit of a complete set of consolidated general purpose financial statements (comparative).
- Management is responsible for the preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in AU-C section 210, *Terms of Engagement*.
- The auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a referred-to auditor in accordance with generally accepted auditing standards (GAAS).

³ In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

- The auditor has concluded that an unmodified (that is, "clean") opinion is appropriate based on the audit evidence obtained.
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in accordance with AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.
- The auditor has obtained all the other information prior to the date of the auditor's report and has not identified an uncorrected material misstatement of the other information included in the annual report.
- The auditor has not been engaged to communicate key audit matters.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in AU-C section 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 3— A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a referred-to auditor in accordance with GAAS.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting*

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

framework].

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in section AU-C 720, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

² .In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Illustration 4 — A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Referred-to Auditor in Accordance With Auditing Standards Other Than GAAS

Circumstances are the same as in illustration 2, except in this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a referred-to auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the referred-to auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the referred-to auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

Opinion

We have audited the consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

We did not audit the financial statements of B Company, a wholly owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with [describe the set of auditing standards], whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States of America performed by, the other auditors.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. In preparing the consolidated financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for *[insert the time period set by the applicable financial reporting framework]*.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risk. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed.²
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Other Information [or another title, if appropriate, such as "Information Other Than the Financial Statements and Auditor's Report Thereon"]

[Reporting in accordance with the reporting requirements in AU-C section 720, The Auditor's

² In circumstances in which the auditor also has responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the consolidated financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

Responsibilities Relating to Other Information Included in Annual Reports.]

Report on Other Legal and Regulatory Requirements

[The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.]

[Signature of auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]

A222.

Appendix A: Understanding the Group's System of Internal Control

(Ref: par. A97)

1. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how AU-C section 315¹ is to be applied in relation to an audit of group financial statements. The examples may not be relevant to every group audit engagement and the list of examples is not necessarily complete.

Control Environment

2. The group auditor's understanding of the control environment may include matters such as the following:
 - The structure of the governance and management functions across the group, and group management's oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group.
 - How oversight over the group's system of internal control by those charged with governance is structured and organized.
 - How ethical and behavioral standards are communicated and reinforced in practice across the group (e.g., group-wide programs, such as codes of conduct and fraud prevention programs).
 - The consistency of policies and procedures across the group, including a group financial reporting procedures manual.

The Group's Risk Assessment Process

3. The group auditor's understanding of the group's risk assessment process may include matters such as group management's risk assessment process, that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements. It may also include an understanding of how sophisticated the group's risk assessment process is and the involvement of entities and business units in this process.

The Group's Process to Monitor the System of Internal Control

4. The group auditor's understanding of the group's process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, when relevant, activities of the internal audit function across the group. The group's internal audit function, including its nature, responsibilities, and activities in respect of monitoring of controls at entities or business units in the group. AU-C section 610² requires the auditor to evaluate the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a systematic and disciplined approach, including quality control.

The Information System and Communication

5. The group auditor's understanding of the group's information system and communication may include matters such as the following:
 - The extent of centralization in the group's IT environment and the commonality of IT applications, IT processes and IT infrastructure.
 - Group management's monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to

¹ Appendix C of AU-C section 315

² Paragraph 13 of AU-C section 610, *Using the Work of Internal Auditors*

monitor performance against budgets, and to take appropriate action.

- Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances at the group level.
- A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group.

Consolidation Process

6. The group auditor's understanding of the consolidation process may include matters such as the following:

- Matters relating to the applicable financial reporting framework:
 - The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework.
 - The process for identifying and accounting for entities or business units in the group in accordance with the applicable financial reporting framework.
 - The process for identifying reportable segments for segment reporting in accordance with the applicable financial reporting framework.
 - The process for identifying related party relationships and related party transactions for reporting in accordance with the applicable financial reporting framework.
 - The accounting policies applied to the group financial statements, changes from those of the previous financial year, and changes resulting from new or revised standards under the applicable financial reporting framework.
 - The procedures for dealing with entities or business units in the group with financial year-ends different from the group's year-end.

Matters relating to the consolidation process:

- Group management's process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial statements, and that differences in accounting policies are identified, and adjusted when required in terms of the applicable financial reporting framework. Uniform accounting policies are the specific principles, bases, conventions, rules, and practices adopted by the group, based on the applicable financial reporting framework, that the entities or business units in the group use to report similar transactions consistently. These policies are ordinarily described in the financial reporting procedures manual and reporting package issued by group management.
- Group management's process for ensuring complete, accurate and timely financial reporting by the entities or business units in the group for the consolidation.
- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial statements.
- How the group's IT environment is organized for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters relating to consolidation adjustments and reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorization and processing of related journal entries, and the experience of personnel responsible for the consolidation.
- The consolidation adjustments required by the applicable financial reporting framework.

- The business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature, and size of transactions between entities or business units in the group.
- The procedures for monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealized profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework.
- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (e.g., an obligation of the minority interest to make good such losses).

Control Activities

7. The group auditor's understanding of the control activities component may include matters such as the following:
 - The commonality of information processing controls and general IT controls for all or part of the group.
 - The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial statements at the assertion level.
 - The extent to which commonly designed controls have been implemented consistently for all or part of the group.

A223.

Appendix B: Examples of Events or Conditions that May Give Rise to Risks of Material Misstatement of the Group Financial Statements

(Ref: par. A123)

The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement of the group financial statements, whether due to fraud or error, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorized by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degree. Also see Appendix B, "Understanding Inherent Risk Factors," of AU-C section 315.

Inherent Risk Factor	Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Statements at the Assertion Level:
Complexity	<ul style="list-style-type: none"> • The existence of complex transactions that are accounted for in more than one entity or business unit in the group. • The application of accounting policies by entities or business units in the group that differ from those applied to the group financial statements. • Accounting measurements or disclosures that involve complex processes used by entities or business units in the group such as accounting for complex financial instruments. • Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation.
Subjectivity	<ul style="list-style-type: none"> • Judgments regarding which entities or business units in the group require incorporation of their financial information in the group financial statements in accordance with the applicable financial reporting framework, for example, whether any variable interest entities or non-trading entities exist and require incorporation. • Judgments regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group.
Change	<ul style="list-style-type: none"> • Frequent acquisitions, disposals, or reorganizations.
Uncertainty	<ul style="list-style-type: none"> • Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade and fiscal policy, and restrictions on currency and dividend movements; and fluctuations in exchange rates.
Susceptibility to Misstatement Due to Management Bias or Other Fraud Risk Factors Insofar as They Affect	<ul style="list-style-type: none"> • Unusual related party relationships and transactions. • Entities or business units in the group with different financial year-ends, which may be utilized to manipulate the timing of transactions.

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Inherent Risk	<ul style="list-style-type: none">• Prior occurrences of unauthorized or incomplete consolidation adjustments.• Aggressive tax planning within the group, or large cash transactions with entities in tax havens.• Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.• Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk.
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Indicators that the control environment, the group's risk assessment process, or the group's process to monitor the group's system of internal control are not appropriate to the group's circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group's system of internal control, include:

- Poor corporate governance structures, including decision making processes that are not transparent.
- Non-existent or ineffective controls over the group's financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group.