

AUDIT PRACTICE BULLETIN NO. 1 OF 2015

AUDITS OF GROUP FINANCIAL STATEMENTS (INCLUDING THE WORK OF COMPONENT AUDITORS)

INTRODUCTION

1. A group audit engagement is when a group audit opinion is issued for the audit of a company with multiple components, such as subsidiaries reporting to a holding company or branches reporting to a head office. For such audit engagements, SSA 600 Special Considerations – Audits of Group Financial Statements (including the work of Component Auditors) applies. It stipulates the level of involvement required of a group engagement team throughout the engagement so as to ensure that the underlying work performed by the component auditors is sufficient to support the audit opinion on the group financial statements. Specifically, SSA 600 paragraph 11 sets out the responsibility of the group engagement partner in the audit of group financial statements. The group engagement partner is responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and applicable legal and regulatory requirements, and whether the auditor's report that is issued is appropriate in the circumstances.
2. In ACRA's practice reviews under the Practice Monitoring Programme, deficiencies in complying with SSA 600 were repeatedly noted and reported in the 2012, 2014 and 2015 annual reports¹. Hence, the purpose of this Audit Practice Bulletin is to provide guidance and clarity on the audit procedures necessary prior to placing reliance on the work performed by component auditors, and to reiterate the need to increase the level of rigour and professional scepticism expected of the public accountant when acting as the group engagement auditor, together with illustrative examples.
3. A group audit can be divided into three phases; namely planning, execution and completion. The key deficiencies arising from the different phases of a group audit engagement as noted in ACRA's practice reviews were as follows:

Planning

- Incorrect assessment of significant component(s)
- Incorrect or no materiality established for the group and component(s)
- Lack of timely or no communication with the component auditors on:
 - i) the identification of the significant risks of material misstatements of the group financial statements;
 - ii) the allocated component materiality; and
 - iii) the appropriate audit procedures to be performed and the form and content of the component auditors' communication with the group engagement team

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Practice Monitoring Programme public reports are available at
<https://www.acra.gov.sg/training-and-resources/publications/reports/practice-monitoring-programme-public-reports>

Execution

- Inadequate audit evidence obtained from the work performed by the component auditors to support the group audit opinion
- No evaluation on the sufficiency of the work performed by the component auditors to support the group audit opinion

Completion

- Inadequate retention of audit evidence to support the group audit opinion

PLANNING

4. In most instances, the deficiencies occur due to a lack of audit planning. Such deficiencies in this phase of a group audit engagement can be avoided if public accountants do the following:
 - a) **Adopt a change of mindset** and be aware that the clarified SSA 600 had set new standards and the group engagement team cannot simply rely on component auditors (e.g. relying only on audit clearances obtained from component auditors or signed audited financial statements).
 - b) **Understand the basic principles and requirements of SSA 600**, in particular on certain specifics such as definitions of components, allocated component materiality, and the use of various financial metrics and consideration of qualitative factors used to determine significant components. Attend training courses if unclear on what these are.
 - c) **Be involved right from the start** by:
 - having a good understanding of the group, its environment and businesses;
 - reviewing the group's financial statements for the year of audit and doing a comparison with prior year; and
 - having discussions with management to understand current year developments so as to determine whether these will impact the audit procedures to be performed at the group and the components. [SSA 600.17-20]
 - d) **Identify and assess the significant areas** of the group financial statements which are subject to risk of material misstatements and/or material financial statement captions for the year of audit. Do not assume that these are the same as prior years without a proper re-assessment in the current year.
 - e) **Identify the significant components** contributing to the group's financial statements. Given the nature of the group structure and its business activities, determine the appropriate benchmark (such as group assets, revenue or profit) to use when assessing components that are of individual or aggregate financial significance. An inappropriate benchmark will result in an incorrect identification of significant components and the group engagement team will not be able to obtain sufficient appropriate audit evidence on the significant components to conclude on the group financial statements.

Other than quantitative factors, qualitative factors specific to the component and requiring special audit consideration should also be included e.g. whether there are any significant account balances, classes of transactions or disclosures, which are linked to the components. All considerations should be documented. An illustrative example of the assessment of significant components is set out in **Table 1** below. [SSA 600.26-29]

Table 1: Illustrative example of assessment of significant components

Component	Contribution to group profits		Contribution to group revenue	
	FY2014	FY2013	FY2014	FY2013
Holding company	21%	21%	13%	13%
Subsidiary X	42%	51%	16%	30%
Subsidiary Y	12%	11%	58%	46%
Subsidiary Z	25%	17%	13%	11%
	100%	100%	100%	100%

<ul style="list-style-type: none"> • The group is in the business of providing contract manufacturing services • Historically the group has been generating low profits • Revenue is one of the key indicators used to measure management’s performance 	
Assessment by the group engagement team	What should have been the correct assessment
<ul style="list-style-type: none"> • Chosen profits as the benchmark to identify components that were of individual financial significance. Applied the suggested 15% threshold in SSA 600 A.5 to the profits benchmark, and therefore the Holding company, Subsidiaries X and Z were identified as significant components 	<ul style="list-style-type: none"> • Understand the nature of the group’s business activities and the financial metrics used to measure management performance. In this case, being a contract manufacturer, the group ran a high volume, low margin business and hence revenue would also be an appropriate indicator of the level of business activities • Based on the revenue benchmark, Subsidiary Y would be a significant component given that it contributed to more than half of the group’s revenue • Accordingly, the group engagement team could consider applying both the revenue and profits benchmarks to ensure that all significant components are identified for full scope reporting by the component auditors

- f) **Set group and component materiality** as these direct the planning of the appropriate audit procedures to reduce the level of uncorrected and undetected misstatements in the group financial statements. If the component materiality is not properly set, the audit procedures performed by the component auditors may not adequately address the significant risks of misstatements of the group financial statements and may give rise to:

- i) inadequate audit procedures performed on the significant components;
- ii) potential uncorrected misstatements not reported at the group level; and
- iii) an incomplete assessment of the aggregated uncorrected misstatements in the group financial statements

Whilst the determination of component materiality is a matter of professional judgement, the group engagement team may also consider the following factors such as, but not limited to:

- the size of the component;
- the characteristics resulting in the component being significant;
- the component’s control environment; and
- the risk of misstatements, taking account of past experience on the component.

It is important to note that individual component materiality should not exceed the group materiality, and the sum of all component materiality may exceed group materiality. An illustrative example is set out in **Table 2** below. [SSA 600.21-23]

Table 2: Illustrative example of component materiality incorrectly set

Work performed	What should have been performed
<ul style="list-style-type: none"> • Set only the group materiality at \$5 million and documented that <i>“the component auditors would know best what is their respective materiality”</i> • Sent group instructions for full scope audits with no component materiality set. As a result, one component auditor performed the audit based on its local statutory audit materiality, which was 20% higher than the group materiality 	<ul style="list-style-type: none"> • Determine and assign an appropriate component materiality to each of the component auditors Where the group engagement team decides to use the statutory audit materiality of the component as the component materiality, the group engagement team needs to assess the appropriateness of the component's statutory audit materiality for the purposes of the group audit • Assess the appropriateness of the component performance materiality applied by the component auditors • Ensure that the component materiality is lower than the group materiality

- g) **Determine the audit procedures to respond to the assessed risks**, including the type of work to be performed by the component auditors and the nature, timing and extent of the group engagement team’s involvement in the work of the component auditors, and the need to review the audit working papers of any component auditors. The group engagement team should also assess the competency of the component auditors. [SSA 600.19, 30-31].

It is important that the group engagement team involve the component auditors when planning the appropriate procedures in response to the assessed risk of misstatements of the group financial statements. If the risk assessment with the component auditors is not performed, certain significant risks to the group financial statements may not have been timely identified, and the group engagement team may not be able to obtain sufficient audit evidence to conclude on the group opinion.

- h) **Prepare a set of group audit instructions** (“GAI”) to the component auditors to include current year developments, significant areas which are subject to risk of material misstatements, component materiality, and any specific audit procedures to be performed by the component auditors. Send these out on a timely basis and ensure that the component auditors understand and follow the form and content of their communication with the group engagement team to ensure appropriate documentation of the work performed and the audit evidence obtained by the component auditors are duly communicated to the group engagement team. [SSA 600.40 and 41]

EXECUTION

5. Having done all the necessary planning work, the common pitfalls for the deficiencies in the execution and completion phases are the lack of rigour in following through on the audit plan sent out to the component auditors, inadequate assessment of the sufficiency of work performed by the component auditors, and the lack of documentation on how the group engagement was able to conclude that the work performed by both the component auditors and the group engagement team were sufficient to base the group audit opinion. [SSA 600.42-45 and 50]
6. In instances where the reporting deliverables as requested in the GAI were not received from the component auditors, ACRA noted that public accountants would use the component auditors’ draft audited financial statements received to verify the financial information consolidated in the group financial statements, without first obtaining sufficient audit evidence on the accuracy of the draft financial statements.

Receipt of only the draft audited financial statements is not acceptable as it would not allow the group engagement team to assess the adequacy of work performed by the component auditors. It is crucial that the public accountant evaluates upfront whether the group engagement team will be able to be involved in the work of component auditors, including having unrestricted access to component auditors and their audit work papers. If, prior to accepting the group audit engagement, the public accountant reasonably expects that there will be an inability to obtain sufficient appropriate audit evidence on the component auditors’ work, the public accountant should consider the requirements of SSA 210 *Agreeing the Terms of Audit Engagements*² and SSA 600³ before determining if he can and should accept the engagement.

² SSA 210 para 7 states that “If management or those charged with governance impose a limitation on the scope of the auditor’s work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.”

³ SSA 600 para 12 states that “If the group engagement partner concludes that:

If a scope limitation situation happens after the public accountant has accepted the engagement, the group engagement team should seriously consider options such as **(i) working with group management to gain direct access to the significant components to perform audit work for the purpose of group consolidation or (ii) issuing a modified audit opinion.**

In this regard, ACRA strongly encourages all public accountants to cooperate with one another in group audit situations, whether acting as the group auditor or the component auditor, e.g. responding to group audit instructions, allowing access to working papers etc.

An illustrative example of how to go about planning and executing a group audit engagement is explained in **Table 3 below.**

Table 3: Illustrative example of how a group audit should be planned and executed

<ul style="list-style-type: none"> • Company X is the major shareholder of Subsidiary H, a listed company. • Both Company X and Subsidiary H share the same financial year-end, i.e. 31 December. • Subsidiary H contributes 85% and 78% to the group’s revenue and profits respectively. Subsidiary H is considered a significant component and is audited by a Big-Four firm, Component Auditors M. • Group Auditor A has been the group auditor of Company X since 2008. Every year, Group Auditor A sends out group audit instructions (“GAI”) to Component Auditors M, requesting them to report on work performed on the significant risks but Component Auditors M has never responded to the request. Group Auditor A also does not have access to Component Auditors M’s audit working papers. • Subsidiary H issued its annual report in March 2015 whilst Company X issued the audited group financial statements in July 2015. 	
Work performed	What should have been performed
<ul style="list-style-type: none"> • Determined component materiality to be the same as group materiality of \$6 million • Relied on Component Auditors M’s FY2013 report to the Audit Committee (obtained through from the client) in February 2015 to identify significant risks for the FY2014 audit • Sent the GAI to Component Auditors M on 2 April 2015 	<p><u>To determine and assign a component materiality:</u></p> <ul style="list-style-type: none"> • Determine and assign a component materiality for Subsidiary H that is lower than the group materiality; a high component materiality would increase the probability that the aggregated uncorrected and undetected misstatements of the components may exceed the group materiality • Communicate to Component Auditors M in the GAI to perform the audit based on the assigned component materiality

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- (a) it will not be possible for the group engagement team to obtain sufficient appropriate audit evidence due to restrictions imposed by group management; and
- (b) the possible effect of this inability will result in a disclaimer of opinion on the group financial statements, the group engagement partner shall either not accept the engagement or where law or regulation prohibits an auditor from declining an engagement, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements.”

<p>communicating the above and informed them that the reporting deadline was 28 April 2015. Similar to prior years, there was no response or acknowledgement from Component Auditors M</p> <p><u>Alternative work performed:</u></p> <ul style="list-style-type: none"> • Reviewed the FY2014 annual report and announcements on the Singapore Exchange (“SGX”) website issued subsequent to year end • Held a conference call with the audit senior manager of Component Auditors M in June 2015. Documented a brief description of the audit procedures performed by Component Auditors M and concluded that no exceptions were noted and the work performed by Component Auditors M could be relied upon for consolidation purposes. • Checked the group consolidation and the group financial statements prepared by Company X to Subsidiary H’s FY2014 annual report 	<p><u>To identify the group’s significant risks of material misstatements:</u></p> <ul style="list-style-type: none"> • Group Auditor A should: <ul style="list-style-type: none"> i) discuss with Group management and/or Component Auditors M to understand the component’s business activities ii) assess the significance of the risks of material misstatement identified by Component Auditors M to the group’s financial statements iii) determine the additional audit procedures required to be performed by the component auditor in response to the identified significant risks and communicate these to Component Auditors M (if the group auditor concludes that work planned by the component auditor is insufficient) iv) not place sole reliance on an outdated report to the Audit Committee without assessing the relevance and completeness of the significant risks to the current year’s audit <p><u>To follow-up on the group reporting deliverables due from Component Auditors M:</u></p> <ul style="list-style-type: none"> • Follow-up on the non-receipt of reporting deliverables. Request group management for assistance to follow-up on the outstanding group reporting deliverables • If this fails, consider issuing a modified audit opinion as this constitutes a limitation of scope <p><u>To ensure sufficient audit evidence obtained from the work performed by Component Auditors M:</u></p> <ul style="list-style-type: none"> • Ensure there is sufficient audit evidence of work performed by Component Auditors M (refer to Tables 4, 5 and 6 on what would be considered sufficient audit evidence). • Given the significance of Subsidiary H, Group Auditor A should work with group management to ensure access to Component Auditors M’s audit working papers or consider this a limitation of scope.
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EXECUTION – Documentation and Retention of Audit Evidence

7. After the group auditor ensures the receipt of group reporting deliverables, he must also ensure the adequacy of audit documentation either in the deliverables or the group audit working papers to provide evidence of work performed on the components. Often, public accountants are unsure what is considered sufficient documentation and hence ACRA would like to clarify that the guiding principle is that there must be documentation **sufficient enough for an external party, such as ACRA, to assess how the group engagement team was able to conclude that the work performed by both the component auditors and the group engagement team were sufficient to base the group audit opinion.**

8. Clear examples of what would be considered insufficient documentation are:
 - Audit clearance with only simple “yes” or “no” answers to the audit questionnaire and no further explanation of the nature, timing and extent of audit work performed.
 - Receipt of the audit planning memorandum (“APM”), audit clearance and salient review memorandum (“SRM”) where:
 - (i) Identification of the significant areas which were subject to risk of material misstatements in the APM differed from those reported in the SRM, or
 - (ii) Responses in the SRM on the significant areas which were subject to risk of material misstatements were not sufficiently detailed to enable an independent reviewer to assess if the work performed and its results were adequate to support the group audit opinion.

9. Where it is not apparent from the reporting deliverables, the group auditor should supplement the documentation to provide evidence that the significant risks of misstatements have been addressed as illustrated in **Table 4** below.

Table 4: Illustrative example of supplemental documentation on inventory valuation

Reported in the SRM	What should have been documented
<ul style="list-style-type: none"> • <i>“Reviewed inventory ageing list, recomputed unit inventory costing and performed purchases cut-off, with no exceptions noted for each of the work performed.”</i> 	<ul style="list-style-type: none"> • An example of supplemental documentation to be made in the group audit files would be: <i>“Based on the review of the component auditors’ audit working papers, it was noted that the increase in inventories as at year-end was due to a build-up in preparation of two large orders after the year-end, and management tracked the ageing of inventories. Inventories aged more than three years amounted to \$1.5 million, of which management had provided \$1.3 million for inventories obsolescence.⁴</i> <i>In addition to the work performed as stated in the component auditors’ SRM, the component auditors had made an inquiry with management and corroborated that the inventories have a shelf life of 3 years. They had also checked to supporting documents and noted that these aged inventories of more than three years can be sold at a discounted value of</i>

⁴ In certain circumstances, this documentation would be available in the overall analytical review submitted by the component auditors to the group engagement team. If this is the case, it may not be necessary to duplicate the same in the group auditor’s supplemental documentation.

	<p><i>“\$0.2 million and hence, the provision of \$1.3 million was adequate. Accordingly, the group engagement team concurred with the component auditor’s conclusion that inventories were reasonably valued.”</i></p> <ul style="list-style-type: none"> • The supplemental documentation not only explained why the risk of misstatement on inventory valuation was reduced, but also explained why the component work performed was reasonable under the circumstances. More significantly, the documentation ended with an overall conclusion by the group engagement team which linked the work performed and the audit assertion that inventory valuation was not materially misstated.
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10. Where the group auditor had held discussions with the component auditors to ensure significant risks of misstatements have been addressed, he should also duly document the discussions as illustrated in **Table 5** below.

Table 5: Illustrative example on documenting the communication with component auditors to be retained as audit evidence

Work performed	What should have been documented
<ul style="list-style-type: none"> • Reviewed the component auditors’ working papers on 28 January 2015 • Documented in the review memorandum that the component auditors had reviewed the discounted cash flows and assessed that the impairment loss of plant and equipment of \$10 million was adequate • Noted that the component auditors reported in the draft financial statements that an impairment loss of plant and equipment of \$15 million was recorded • Held a teleconference call with the component auditors on 14 February 2015 to discuss all outstanding matters including the additional impairment loss of \$5 million recorded 	<ul style="list-style-type: none"> • The group auditor should have documented his further discussions with the group auditor on: <ul style="list-style-type: none"> • the work performed by the component auditors to assess the additional impairment; and • why he concurred with the additional impairment • An example of the documentation is as follows: <p><i>“Understood from the component auditors that the additional impairment arose because the DCF at the point of our review of the working papers was not yet finalised. This coincided with the documentation in our review memorandum which stated that the impairment loss of \$10 million was based on a draft copy of management’s DCF.</i></p> <p><i>We further understood that the reason for the increase in impairment loss was due to a change in business plans for the subsidiary, in that management decided to shut down the operations at site XX. Accordingly, the PPE from this site would be impaired.</i></p> <p><i>The component auditors had tested the completeness of the additional PPE impaired by performing a reasonableness test of the remaining NBV using the opening balances of PPE at this site</i></p>

<ul style="list-style-type: none"> Documented in the minutes that “all items on the agenda had been discussed and satisfactorily resolved” 	<p>and their remaining useful lives with no material variances noted. In addition to ensure completeness of the additional impairment, the component auditor had also obtained the listing of PPE to ensure that machines which were specific to the production line in XX had been impaired. We also confirmed with the Group CFO that the operations at site XX will be shut down by [date]. Hence, based on the above, we concur with the additional impairment loss made.”</p>
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11. In cases where the group auditor had reviewed relevant parts of the component auditors’ audit documentation, the group auditor should ensure that he duly documents as illustrated in **Table 6** below, (a) the nature, extent, timing and conclusions of work that was performed by the component auditors and (b) his assessment on the adequacy of the work performed in respect of the significant risks of misstatements. Such documentation should be retained in the group audit files in Singapore⁵.

Table 6: Illustrative example on evidence of work performed by component auditors to be retained in the group audit files

Work performed	What should have been retained in the group engagement team’s audit working papers
<ul style="list-style-type: none"> Reviewed the final reporting deliverable from the component auditors where the component auditors reported that they had reviewed management’s discounted cash flows (“DCF”) and concurred with management that no impairment on property, plant and equipment (“PPE”) was required for a loss-making component Visited the component auditors to review the audit working papers Documented “concur no impairment was required” 	<ul style="list-style-type: none"> Assessment of the work performed by the component auditors in the review of the DCF, such as: <ul style="list-style-type: none"> the assumptions used by management in preparing the DCF the work performed by the component auditors to assess the reasonableness of the assumptions such as growth rates, discount rates, terminal value, etc. the results of a sensitivity analysis An example of the documentation is as follows: <p>“Memorandum on the review of component auditors’ audit working papers <u>Assessment of impairment of PPE:</u> Noted that the component auditors had reviewed the 5-year DCF prepared by management which included the key assumptions:</p> <p>1) growth rates</p>

⁵ The group auditor may face difficulty in retaining copies of the audit work papers of the component auditors, for example due to legal restrictions of access in certain countries. It is not a requirement of SSA 600 or ACRA’s expectation that the group auditor retains copies of the work papers of the component auditors. However, the group engagement team’s documentation should demonstrate its involvement in the work performed by the component auditors including, where applicable, the review of the component auditors’ audit documentation and conclusions thereon.

<p>next to the above reported item in the final reporting deliverable from the component auditors</p>	<p>2) <i>discount rate, and</i> 3) <i>terminal values</i></p> <p><i>Component auditors had tested the reasonableness of the assumptions as follows:</i> <i>On growth rates:-</i></p> <p>1) <i>Management had applied revenue growth rates of 3% in FY 2016, 5% in FY 2017 and 2018, and 3% for the remaining 2 years.</i></p> <p>2) <i>Component auditors had assessed the rates used to be reasonable as the company had signed a new 3-year contract with a new customer in 4Q 2015.</i></p> <p>3) <i>Detailed work performed included:</i></p> <ul style="list-style-type: none"> • <i>Corroborated management’s representations by sighting the new contract</i> • <i>Based on the terms of the contract, obtained details of the expected revenue, and checked to supporting documents, such as gross profit margins for similar projects completed in the past, current pricing, and price quotes from vendors, etc.</i> • <i>Assessed the percentage of revenue recognised in each of the 3 years of projection based on past projects’ milestones for similar projects</i> <p><i>In response to our queries, component auditors also provided the following additional evidence and/or information that:</i></p> <p>1) <i>The new contract would have increased utilisation of the company’s current capacity from the current level of 55% to 72%; and</i></p> <p>2) <i>The company had historically been conservative in its budgets, and that the actual results for the past 3 years usually met or came close to the budgets set.</i></p> <p><i>Based on the above work performed, we concur that growth rates used by management are reasonable.</i></p> <p><i>On discount rates:-</i> ”</p>
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EXECUTION – Assessment of Component Auditor’s Work

12. Even when a component auditor provides sufficiently detailed reports about his audit work, the group auditor needs to evaluate whether the audit procedures are relevant, appropriate and sufficient to arrive at the same conclusion with the component auditor. If the group auditor concludes that the audit procedures performed by the component auditor are not appropriate or insufficient, the group auditor should perform/request the component auditor to perform additional procedures. An illustrative example of such evaluation is set out in **Table 7** below:

Table 7: Illustrative example of work performed to evaluate the reasonableness of discount rate used in a cash flow forecast

Work performed by component auditor	What should have been performed
<ul style="list-style-type: none"> • Assessed key assumptions used by the component management in preparing discounted cash flow forecast • Re-computed the discount rate of 3% based on management’s factors • Concluded discount rate of 3% was reasonable and hence no impairment of asset was needed 	<ul style="list-style-type: none"> • Apply professional skepticism and assess if conclusion of no impairment was consistent with other quantitative and qualitative indicators of impairment e.g. deterioration of economic conditions, loss of major customer contracts, idle capacity etc. • Be alert to the fact that a discount rate higher than 3% would result in an impairment loss that has significant impact to the group financial statements • Independently perform a sense-check to assess reasonableness of key management assumptions e.g. check if discount rate of 3% is reasonable vis-à-vis the risk-free rate in the country of operation e.g. check if the discount rate of 3% is reasonable vis-à-vis discount rates used by other businesses with similar size and complexity of operations (information often available publicly) • Perform sensitivity analysis of key management assumptions and assess risk of asset impairment⁶

13. When evaluating the adequacy of the component auditors’ work, it is also crucial that the group auditor consider whether the initial risk assessment remains appropriate as a result of identified significant deficiencies in internal controls at the component level and whether additional audit procedures are necessary.

⁶ If the component auditors had not performed a sensitivity analysis of key assumptions, the group engagement team may consider requesting such procedures to be performed by the component auditors or otherwise perform it at the group level

14. The group auditor’s assessment should also include an evaluation of whether differences in accounting standards and policies have been duly adjusted by the component auditor as instructed in the group audit instructions and whether further adjustments are needed at the group level as illustrated in **Table 8** below:

Table 8: Illustrative example of work performed to evaluate the need for further adjustments to align the accounting standards and policies of the component to the group

Work performed	What should have been performed
<ul style="list-style-type: none"> • Sent group instructions for component auditors to provide clearance in IFRS which includes adjusting the revenue recognition of construction contracts from the completion method to the percentage of completion (“POC”) method • Received the group consolidation package and noted that the revenue recognition policy for construction contracts was the completion method • Enquired with the component auditors who responded that they are unable to provide IFRS clearance unless management pays a separate set of audit fees • Concluded that <i>“as the construction contracts are generally completed within a short period of one year, there is unlikely to be material differences in the revenue recognised on the completion method vs the percentage of completion method. Suggest to leave.”</i> 	<ul style="list-style-type: none"> • Assess whether there are differences in the accounting standards and policies applied by the component vs the group • Discuss with management to ensure that the component’s financial statements are duly adjusted according to the group’s accounting standards and policies. This includes the agreement for the component auditors to issue an IFRS clearance • If the component auditors are unable to issue an IFRS clearance, the group auditor should work with management to assess the materiality of the GAAP differences and determine if a group level adjustment and audit is necessary

COMPLETION

15. Before the public accountant issues the group audit opinion, it is crucial to ensure that:
- (i) sufficient appropriate audit evidence has been obtained from the component auditors;
 - (ii) all significant outstanding matters (relevant for group reporting) highlighted by the component auditors have been appropriately cleared;
 - (iii) all outstanding deliverables e.g. subsequent events review have been received from the component auditors; and

- (iv) uncorrected misstatements from component auditors have been collated and evaluated for the effect on the group audit opinion.

Otherwise, the group auditor is at risk of issuing an inappropriate group audit report as illustrated in **Table 9** below.

Table 9: Illustrative example of inappropriate group audit opinion due to non-resolution of outstanding matters and late receipt of subsequent events review by component auditors

Timeline set for a group audit for the financial year ended 31 December 2014	
<p>The diagram shows a horizontal timeline with four vertical tick marks. Above the timeline, the following events are listed: 'Interim reporting deliverables due from the component auditor' at 30 November 2014; 'Final reporting deliverables due from the component auditor' at 25 February 2015; '1) Subsequent event review memorandum due from the component auditor' and '2) Group audit report sign-off' at 31 March 2015; and 'Subsequent event review memorandum received from the component auditor' at 5 April 2015.</p>	
Work performed	What should have been performed
<ul style="list-style-type: none"> Reviewed the final reporting deliverables from the component auditors and noted two outstanding matters highlighted on the non-receipt of one bank confirmation and the subsequent receipts review of two major trade debtors (representing 15% of the group’s total assets) Noted that the subsequent events review memorandum was not yet received from the component auditors and proceeded to perform a variance analysis of the component (contributing 20% to the group’s revenue) based on its unaudited management accounts. The variance analysis did not show up any significant fluctuations Signed off the group audit opinion on 31 March 2015 Received the subsequent events memorandum from the component auditors on 5 April 2015 to update that one of the major customers had filed for bankruptcy on 15 Dec 2014. Accordingly, the trade debts owing would no longer be recoverable and the revenue targets used for any impairment testing would 	<ul style="list-style-type: none"> Follow-up with the component auditors on the outstanding matters prior to the date of the group audit report sign-off by making sure that they are satisfactorily resolved <u>AND</u> this is duly supported with sufficient documentation in the group audit files. This can be done either by: <ul style="list-style-type: none"> obtaining an updated memorandum from the component auditors that <u>explains</u> how these two outstanding items were satisfactorily resolved; or if an updated memorandum was not obtained, documenting directly in the group audit files, the discussions with the component auditors about the work performed to resolve the two outstanding matters with an assessment of the sufficiency of work performed Ensure the receipt of the subsequent events review memorandum from the component auditors before 31 March 2015. Otherwise, a direct enquiry should be made with the component auditors to understand if there were any reasons for the delay and whether they expected to

have to be adjusted downwards	report any material events that would affect group financial statements. The results of the inquiry should be documented and filed as part of audit evidence
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16. In summary, what public accountants should do during the execution and completion phases of a group audit engagement are as follows:
- a) Follow-up with the component auditors on the work performed and the audit evidence obtained over the significant risks of material misstatements;
 - b) Engage the component auditors to understand the work performed and audit evidence obtained;
 - c) Exercise due diligence and professional skepticism in the review of the component auditors' work; and
 - d) Document and retain audit evidence gathered (by both the component auditors and the group engagement team) to support the group audit opinion.

APPLICATION OF THE PRINCIPLES OF GROUP AUDITS TO JOINT AUDITS

17. Audit Guidance Statement (“AGS”) 10 deals with the key principles of joint audits including the roles and responsibilities of joint auditors, the principal audit procedures and quality control considerations under joint audit arrangements, communication and audit documentation requirements of joint audits.
18. The role and responsibilities of the joint auditor is similar to the objectives of a group auditor. While the audit work under a joint arrangement may be distributed between the joint auditor and other auditor(s), the joint auditor is responsible for the work of the other auditor(s) as both/all auditors are jointly and severally responsible for the audit, as well as the audit opinion expressed on the financial statements. Hence it is important that the joint auditor retains the audit evidence obtained from the work performed by the other auditor(s) in his/her set of audit working papers.
19. Hence, the principles applicable to group audits as highlighted in paragraphs 3 to 16 are also relevant to joint audits as both the group auditor and joint auditors have the same responsibility to obtain sufficient appropriate audit evidence on the work performed by other auditors (component auditors and joint auditors), and retain the evidence of such work performed to form an audit opinion on the financial statements.

CONCLUSION

19. Due to globalisation and increase in overseas investments, it is common for Singapore-incorporated companies to have overseas operations, thus creating complexity in managing audits of foreign subsidiaries. Group audits can be even more complex when several component auditors are involved and overseas operations are equally significant. The group engagement team must ensure there is proper planning involving the component auditors, timely involvement and communication throughout the audit process, and audit evidence obtained and retained are sufficient and appropriate. Compliance with revised SSA 600 will continue to be an area of focus in ACRA’s practice reviews.

Note: Please note that the contents of the Audit Practice Bulletin are provided for the guidance of public accountant to supplement prescribed professional standards, and include criteria that ACRA considers in evaluating the work of public accountants. They are not rules of the Accounting and Corporate Regulatory Authority and are not intended to serve as a substitute for the relevant auditing standards. The Public Accountants must observe, maintain and apply the prescribed professional standards, methods, procedures and other requirements in carrying out the audits of financial statements.