

**ASA 600**  
(September 2008)

**Auditing Standard ASA 600**  
*Special Considerations –*  
*Audits of a Group Financial*  
*Report (Including the Work of*  
*Component Auditors)*  
**(Revised and Redrafted)**

Issued by the **Auditing and Assurance Standards Board**

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ISSN 1833-4393

## CONTENTS

PREFACE	
AUTHORITY STATEMENT	
	<i>Paragraphs</i>
<b>Application</b> .....	Aus 0.1-Aus 0.2
<b>Operative Date</b> .....	Aus 0.3
<b>Introduction</b>	
Scope of this Auditing Standard .....	1-6
Effective Date .....	7
<b>Objectives</b> .....	8
<b>Definitions</b> .....	9-10
<b>Requirements</b>	
Responsibilities .....	11
Acceptance and Continuance .....	12-14
Overall Audit Strategy and Audit Plan .....	15-16
Understanding the Group, Its Components and Their Environment .....	17-18
Understanding the Component Auditors .....	19-20
Materiality .....	21-23
Responding to Assessed Risks .....	24-31
Consolidation Process .....	32-37
Subsequent Events .....	38-39
Communication with the Component Auditor .....	40-41
Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained .....	42-45
Communication with Group Management and Those Charged with Governance of the Group .....	46-49
Reporting Considerations .....	Aus 49.1

**Auditing Standard ASA 600**  
*Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)*

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Documentation .....	50
<b>Application and Other Explanatory Material</b>	
Components Subject to Audit by Statute, Regulation or Other Reason .....	A1
Definitions .....	A2-A7
Responsibility .....	A8-A9
Acceptance and Continuance .....	A10-A21
Overall Strategy and Audit Plan .....	A22
Understanding the Group, Its Components and Their Environments .....	A23-A31
Understanding the Component Auditors .....	A32-A41
Materiality .....	A42-A46
Responding to Assessed Risks .....	A47-A55
Consolidation Process .....	A56
Communications with the Component Auditor .....	A57-A60
Evaluation the Sufficiency and Appropriateness of Audit Evidence Obtained .....	A61-A63
Communication with Group Management and Those Charged with Governance of the Group .....	A64-A66
<b>Conformity with International Standards on Auditing</b>	
<b>Appendix 1: Example of a Qualified Opinion where the Group Engagement Team is Not Able to Obtain Sufficient Appropriate Audit Evidence on which to Base the Group Audit Opinion</b>	
<b>Appendix 2: Examples of Matters about which the Group Engagement Team Obtains an Understanding</b>	
<b>Appendix 3: Examples of Conditions or Events that may Indicate Risks of Material Misstatement of the Group Financial Report</b>	
<b>Appendix 4: Examples of a Component Auditor's Confirmations</b>	

**Auditing Standard ASA 600**  
*Special Considerations – Audits of a Group Financial Report (Including  
the Work of Component Auditors) (Revised and Redrafted)*

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**Appendix 5: Required and Additional Matters Included  
in the Group Engagement Team's Letter of  
Instruction**

Draft

## PREFACE

### **Reasons for Issuing Auditing Standard ASA 600** *Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)* **(Revised and Redrafted)**

The Auditing and Assurance Standards Board (AUASB) issues Auditing Standard ASA 600 *Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)* (Revised and Redrafted) pursuant to the requirements of the legislative provisions and the Strategic Direction explained below.

The AUASB is an independent statutory board of the Australian Government established under section 227A of the *Australian Securities and Investments Commission Act 2001* (ASIC Act). Under section 336 of the *Corporations Act 2001*, the AUASB may make Australian Auditing Standards for the purposes of the corporations legislation. These Auditing Standards are legislative instruments under the *Legislative Instruments Act 2003*.

Under the Strategic Direction given to the AUASB by the Financial Reporting Council (FRC), the AUASB is required to have regard to any programme initiated by the IAASB for the revision and enhancement of the ISAs and to make appropriate consequential amendments to the Australian Auditing Standards. Accordingly, the AUASB has decided to revise and redraft the Australian Auditing Standards using the equivalent redrafted ISAs.

## **Main Features**

This Auditing Standard establishes mandatory Requirements and provides Application and Other Explanatory Material regarding the special considerations that apply to group audits, including those that involve component auditors.

This Auditing Standard:

- (a) Describes the responsibilities of the group engagement partner;
- (b) Describes acceptance and continuance requirements;
- (c) Requires an overall audit strategy to be established and an audit plan to be developed;
- (d) Requires the auditor to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment;
- (e) Details the requirements in responding to assessed risks;
- (f) Details the requirements in communicating with component auditors, group management and those charged with governance of the group; and
- (g) Describes specific documentation requirements.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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**AUTHORITY STATEMENT**

The Auditing and Assurance Standards Board (AUASB) makes this Auditing Standard ASA 600 *Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)* (Revised and Redrafted) pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001* and section 336 of the *Corporations Act 2001*.

This Auditing Standard is to be read in conjunction with ASA 100 *Preamble to AUASB Standards* (Redrafted and Revised), which sets out the intentions of the AUASB on how the Australian Auditing Standards are to be understood, interpreted and applied.

## AUDITING STANDARD ASA 600

### ***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)*** **(Revised and Redrafted)**

#### **Application**

- Aus 0.1 This Auditing Standard applies to:
- (a) an audit of a financial report for a financial year, or an audit of a financial report for a half-year, in accordance with the *Corporations Act 2001*; and
  - (b) an audit of a financial report for any other purpose.
- Aus 0.2 This Auditing Standard also applies, as appropriate, to an audit of other historical financial information.

#### **Operative Date**

- Aus 0.3 This Auditing Standard is operative for financial reporting periods commencing on or after 1 January 2010.

#### **Introduction**

##### **Scope of this Auditing Standard**

1. The Australian Auditing Standards apply to group audits. This Auditing Standard deals with special considerations that apply to group audits, in particular those that involve component auditors.
2. This Auditing Standard also applies, as appropriate, when the auditor involves other auditors in the audit of financial reports that are not group financial reports. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location.
3. A component auditor may be required by statute, regulation or for another reason, to express an audit opinion on the financial report of a component. The group engagement team may decide to use the audit evidence on which the audit opinion on the financial report of

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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the component is based to provide audit evidence for the group audit, but the requirements of this Auditing Standard nevertheless apply. (Ref: Para. A1)

4. In accordance with ASA 220 (Revised and Redrafted),<sup>1</sup> the group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively have the appropriate capabilities and competence. The group engagement partner is also responsible for the direction, supervision and performance of the group audit engagement.
5. The group engagement partner applies the requirements of ASA 220 (Revised and Redrafted) regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This Auditing Standard assists the group engagement partner to meet the requirements of ASA 220 (Revised and Redrafted) where component auditors perform work on the financial information of components.
6. Audit risk is a function of the risk of material misstatement of the financial report and the risk that the auditor will not detect such misstatements.<sup>2</sup> In a group audit, this includes the risk that the component auditor may not detect a misstatement in the financial information of the component that could cause a material misstatement of the group financial report, and the risk that the group engagement team may not detect this misstatement. This Auditing Standard explains the matters that the group engagement team considers when determining the nature, timing and extent of its involvement in the risk assessment procedures and further audit procedures performed by the component auditors on the financial information of the components. The purpose of this involvement is to obtain sufficient appropriate audit evidence on which to base the audit opinion on the group financial report.

**Effective Date**

7. [Deleted by the AUASB. Refer Aus 0.3]

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<sup>1</sup> See ASA 220 (Revised and Redrafted) *Quality Control for an Audit of a Financial Report* paragraphs 13 and 14.

<sup>2</sup> See ASA 200 (Revised and Redrafted) *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with Australian Auditing Standards* paragraph A10.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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## **Objectives**

8. The objectives of the auditor are:
- (a) To determine whether to act as the auditor of the group financial report;
  - (b) To communicate clearly with component auditors about the scope and timing of their work on financial information related to components and their findings; and
  - (c) To obtain sufficient appropriate audit evidence about the financial information of the components and the consolidation process to express an opinion whether the group financial report is prepared, in all material respects, in accordance with the applicable financial reporting framework.

## **Definitions**

9. For purposes of the Australian Auditing Standards, the following terms have the meanings attributed below:
- (a) Component means an entity or business activity for which group or component management prepares financial information that should be included in the group financial report. (Ref: Para. A2-A4)
  - (b) Component auditor means an auditor who, at the request of the group engagement team, performs work on financial information related to a component for the group audit. (Ref: Para. A7)
  - (c) Component management means management, or those charged with governance, responsible for preparing the financial information of a component.
  - (d) Component materiality means the materiality level for a component determined by the group engagement team.
  - (e) Group means all the components whose financial information is included in the group financial report. A group always has more than one component. (Ref: Para. A4)

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- (f) Group audit means the audit of a group financial report.
- (g) Group audit opinion means the audit opinion on the group financial report.
- (h) Group engagement partner means the partner or other person in the firm who is responsible for the group audit engagement and its performance, and for the auditor's report on the group financial report that is issued on behalf of the firm. Where joint auditors conduct the group audit, the joint engagement partners and their engagement teams collectively constitute the group engagement partner and the group engagement team. This Auditing Standard 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.
- (i) Group engagement team means partners, including the group engagement partner, and staff who establish the overall group audit strategy, communicate with component auditors, perform work on the consolidation process, and evaluate the conclusions drawn from the audit evidence as the basis for forming an opinion on the group financial report.
- (j) Group financial report means a financial report that include the financial information of more than one component. The term "group financial report" also refers to combined financial reports aggregating the financial information prepared by components that have no parent but are under common control.
- (k) Group management means management, or those charged with governance, responsible for preparing and presenting the group financial report.
- (l) Group-wide controls means controls designed, implemented and maintained by group management over group financial reporting.
- (m) Significant component means a component identified by the group engagement team (i) that is of individual financial significance to the group, or (ii) that, due to its specific nature or circumstances, is likely to include significant risks

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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of material misstatement of the group financial report. (Ref: Para. A5-A6)

10. Reference to “the applicable financial reporting framework” means the financial reporting framework that applies to the group financial report. Reference to “the consolidation process” includes:
- (a) The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial report by way of consolidation, proportionate consolidation, or the equity or cost methods of accounting; and
  - (b) The aggregation in combined financial reports of the financial information of components that have no parent but are under common control.

## **Requirements**

### **Responsibility**

11. The group engagement partner is responsible for the direction, supervision and performance of the group audit engagement in compliance with professional standards and regulatory and legal requirements, and whether the auditor’s report that is issued is appropriate in the circumstances [see ASA 220 (Revised and Redrafted)].<sup>3</sup> As a result, the auditor’s report on the group financial reports shall not refer to a component auditor, unless required by law or regulation to include such reference. If such reference is required by law or regulation, the auditor’s report shall indicate that the reference does not diminish the group engagement partner’s or the group engagement partner’s firm’s responsibility for the group audit opinion. (Ref: Para. A8-A9)

### **Acceptance and Continuance**

12. In applying ASA 220 (Revised and Redrafted), the group engagement partner shall determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained in relation to the consolidation process and the financial information of the components on which to base the group audit opinion. For this purpose, the group engagement team shall obtain an understanding of the group, its components, and their environments that is

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<sup>3</sup> Deleted by the AUASB.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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sufficient to identify components that are likely to be significant components. Where component auditors will perform work on the financial information of such components, the group engagement partner shall evaluate whether the group engagement team will be able to be involved in the work of those component auditors to the extent necessary to obtain sufficient appropriate audit evidence. (Ref: Para. A10-A12)

13. If the group engagement partner concludes that:
- (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 report [see ASA 705 (Revised and Redrafted) *Modifications to the Opinion in the Independent Auditor's Report*],<sup>4</sup>

the group engagement partner shall either:

- In the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, resign from the engagement; or
- Where law or regulation prohibits an auditor from declining or resigning from an engagement, having performed the audit of the group financial report to the extent possible, disclaim an opinion on the group financial report. (Ref: Para. A13-A19)

*Terms of Engagement*

14. The group engagement partner shall agree on the terms of the group audit engagement in accordance with ASA 210 (Revised and Redrafted)[see ASA 210 (Revised and Redrafted) *Agreeing the Terms of Audit Engagements*].<sup>5</sup> (Ref: Para. A20-A21)

**Overall Audit Strategy and Audit Plan**

15. The group engagement team shall establish an overall group audit strategy and shall develop a group audit plan in accordance with

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<sup>4</sup> Deleted by the AUASB.

<sup>5</sup> Deleted by the AUASB..

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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ASA 300 (Revised and Redrafted) [see ASA 300 (Revised and Redrafted) *Planning an Audit of a Financial Report*].<sup>6</sup>

16. The group engagement partner shall review the overall group audit strategy and group audit plan. (Ref: Para. A22)

**Understanding the Group, Its Components and Their Environments**

17. The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment [see ASA 315 (Revised and Redrafted) *Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment*].<sup>7</sup> The group engagement team shall:

- (a) Enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage; and
- (b) Obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: Para. A23-A29)

18. The group engagement team shall obtain an understanding that is sufficient to:

- (a) Confirm or revise its initial identification of components that are likely to be significant; and
- (b) Assess the risks of material misstatement of the group financial report, whether due to fraud or error [see ASA 315 (Revised and Redrafted)].<sup>8</sup> (Ref: Para. A30-A31)

**Understanding the Component Auditors**

19. When the group engagement team plans to request a component auditor to perform work on the financial information of a component, the group engagement team shall obtain an understanding of the following: (Ref: Para. A32-A35)

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<sup>6</sup> Deleted by the AUASB

<sup>7</sup> Deleted by the AUASB

<sup>8</sup> Deleted by the AUASB

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- (a) Whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent; (Ref: Para. A37)
  - (b) The component auditor’s professional competence; (Ref: Para. A38)
  - (c) Whether the group engagement team will be able to be involved in the work of the component auditor to the extent necessary to obtain sufficient appropriate audit evidence; and
  - (d) Whether the component auditor operates in a regulatory environment that actively oversees auditors. (Ref: Para. A36)
20. When a component auditor does not meet the independence requirements that are relevant to the group audit, or the group engagement team has serious concerns about the other matters listed in paragraph 19(a)-(c), the group engagement team shall obtain sufficient appropriate audit evidence relating to the financial information of the component without requesting that component auditor to perform work on the financial information of that component. (Ref: Para. A39-A41)

**Materiality**

21. The group engagement team shall determine the following: (Ref: Para. A42)
- (a) The materiality level for the group financial report as a whole when establishing the overall group audit strategy.
  - (b) Whether, in the specific circumstances of the group, there are particular classes of transactions, account balances or disclosures in the group financial report for which misstatements of lesser amounts than the materiality level for the group financial report as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial report. In such circumstances, the group engagement team shall determine the materiality levels to be applied to those particular classes of transactions, account balances or disclosures.
  - (c) Component materiality for those components where component auditors will perform an audit or a review for

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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purposes of the group audit. To reduce the risk that the aggregate of detected and undetected misstatements in the group financial report exceeds the materiality level for the group financial report as a whole, component materiality shall be lower than the materiality level for the group financial report as a whole. (Ref: Para. A43-A44)

- (d) The threshold above which misstatements cannot be regarded as clearly trivial to the group financial report. (Ref: Para. A45)
22. Where component auditors will perform an audit for purposes of the group audit, the group engagement team shall evaluate the appropriateness of the amount or amounts lower than the component materiality level (and the amount or amounts lower than the materiality level for particular classes of transactions, account balances or disclosures, if applicable) determined for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks at the component level. (Ref: Para. A46)
23. When a component is subject to audit by statute, regulation or other reason, and the group engagement team decides to use that audit to provide audit evidence for the group audit, the group engagement team shall determine whether:
- (a) the materiality level determined for the component financial report as a whole; and
  - (b) the lower amounts determined for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks at the component level

meet the requirements of this Auditing Standard.

**Responding to Assessed Risks**

24. The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial reports.<sup>9</sup> The group engagement team shall determine the type of work to be performed by the group engagement team, or the component auditors on its behalf, on the financial information of

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<sup>9</sup> See ASA 330 (Revised and Redrafted), “*The Auditor’s Responses to Assessed Risks.*”

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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the components, see paragraphs 26-29. The group engagement team shall also determine the nature, timing and extent of its involvement in the work of the component auditors, see paragraphs 30-31. (Ref: Para. A47)

25. If the nature, timing and extent of the work to be performed on the consolidation process or the financial information of the components are based on an expectation that group-wide controls are operating effectively, or when substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level, the group engagement team shall test, or request a component auditor to test, the operating effectiveness of those controls.

*Determining the Type of Work to Be Performed on the Financial Information of Components*

**Significant Components**

26. For a component that is significant due to its individual financial significance to the group, the group engagement team, or a component auditor on its behalf, shall perform an audit of the financial information of the component using component materiality.
27. For a component that is significant because it is likely to include significant risks of material misstatement of the group financial report due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, shall perform one or more of the following:
- (a) An audit of the financial information of the component using component materiality.
  - (b) An audit of one or more account balances, classes of transactions or disclosures relating to the likely significant risks of material misstatement of the group financial report. (Ref: Para. A48)
  - (c) Specified audit procedures relating to the likely significant risks of material misstatement of the group financial report. (Ref: Para. A49)

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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Components that are Not Significant Components

28. For components that are not significant components, the group engagement team shall perform analytical procedures at group level. (Ref: Para. A50)
29. If the group engagement team does not consider that sufficient appropriate audit evidence on which to base the group audit opinion will be obtained from:
- (a) The work performed on the financial information of significant components;
  - (b) The work performed on group-wide controls and the consolidation process; and
  - (c) The analytical procedures performed at group level,
- the group engagement team shall select components that are not significant components and shall perform, or request a component auditor to perform, one or more of the following on the financial information of the individual components selected: (Ref: Para. A51-A53)
- An audit of the financial information of the component using component materiality.
  - An audit of one or more account balances, classes of transactions or disclosures.
  - A review of the financial information of the component using component materiality.
  - Specified procedures.

The group engagement team shall vary the selection of components over a period of time.

*Involvement in the Work Performed by Component Auditors* (Ref: Para. A54-A55)

Significant Components—Risk Assessment

30. When a component auditor performs an audit of the financial information of a significant component, the group engagement team shall be involved in the component auditor's risk assessment to

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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identify significant risks of material misstatement of the group financial report. The nature, timing and extent of this involvement are affected by the group engagement team's understanding of the component auditor, but at a minimum shall include:

- (a) Discussing with the component auditor or component management those of the component's business activities that are significant to the group;
- (b) Discussing with the component auditor the susceptibility of the component to material misstatement of the financial information due to fraud or error; and
- (c) Reviewing the component auditor's documentation of identified significant risks of material misstatement of the group financial report. Such documentation may take the form of a memorandum that reflects the component auditor's conclusion with regard to the identified significant risks.

**Identified Significant Risks of Material Misstatement of the Group Financial Report—Further Audit Procedures**

31. When significant risks of material misstatement of the group financial report have been identified in a component on which a component auditor performs the work, the group engagement team shall evaluate the appropriateness of the further audit procedures to be performed to respond to the identified significant risks of material misstatement of the group financial report. Based on its understanding of the component auditor, the group engagement team shall determine whether it is necessary to be involved in the further audit procedures.

**Consolidation Process**

32. In accordance with paragraph 17, the group engagement team obtains an understanding of group-wide controls and the consolidation process, including the instructions issued by group management to components. In accordance with paragraph 25, the group engagement team, or component auditor at the request of the group engagement team, tests the operating effectiveness of group-wide controls if the nature, timing and extent of the work to be performed on the consolidation process are based on an expectation that group-wide controls are operating effectively, or when

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

33. The group engagement team shall design and perform further audit procedures on the consolidation process to respond to the assessed risks of material misstatement of the group financial report arising from the consolidation process. This shall include evaluating whether all components have been included in the group financial report.
34. The group engagement team shall evaluate the appropriateness, completeness and accuracy of consolidation adjustments and reclassifications, and shall evaluate whether any fraud risk factors or indicators of possible management bias exist. (Ref: Para. A56)
35. If the financial information of a component has not been prepared in accordance with the same accounting policies applied to the group financial report, the group engagement team shall evaluate whether the financial information of that component has been appropriately adjusted for purposes of preparing and presenting the group financial report.
36. The group engagement team shall determine whether the financial information identified in the component auditor's communication, see paragraph 41(c), is the financial information that is incorporated in the group financial report.
37. If the group financial report includes the financial report of a component with a financial reporting period-end that differs from that of the group, the group engagement team shall evaluate whether appropriate adjustments have been made to the financial report in accordance with the applicable financial reporting framework.

**Subsequent Events**

38. Where the group engagement team or component auditors perform audits on the financial information of components, the group engagement team or the component auditors shall perform procedures designed to identify events at those components that occur between the dates of the financial information of the components and the date of the auditor's report on the group financial report, and that may require adjustment to or disclosure in the group financial report.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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39. Where component auditors perform work other than audits of the financial information of components, the group engagement team shall request the component auditors to notify the group engagement team if they become aware of subsequent events that may require an adjustment to or disclosure in the group financial report.

**Communication with the Component Auditor**

40. The group engagement team shall communicate its requirements to the component auditor on a timely basis. This communication shall set out the work to be performed, the use to be made of that work, and the form and content of the component auditor's communication with the group engagement team. (Ref: Para. A57, A58, A60) It shall also include the following:
- (a) A request that the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, confirms that the component auditor will cooperate with the group engagement team. (Ref: Para. A59)
  - (b) The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.
  - (c) In the case of an audit or review of the financial information of the component, component materiality (and the amount or amounts lower than the materiality level for particular classes of transactions, account balances or disclosures, if applicable) and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial report.
  - (d) Identified significant risks of material misstatement of the group financial report, due to fraud or error, that are relevant to the work of the component auditor. The group engagement team shall request the component auditor to communicate on a timely basis any other identified significant risks of material misstatement of the group financial report, due to fraud or error, in the component, and the component auditor's responses to such risks.
  - (e) A list of related parties prepared by group management, and any other related parties of which the group engagement team is aware. The group engagement team shall request the component auditor to communicate on a timely basis

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

related parties not previously identified by group management or the group engagement team. The group engagement team shall determine whether to identify such additional related parties to other component auditors.

41. The group engagement team shall request the component auditor to communicate matters relevant to the group engagement team's conclusion with regard to the group audit. Such communication shall include: (Ref: Para. A60)
- (a) Whether the component auditor has complied with ethical requirements that are relevant to the group audit, including independence and professional competence;
  - (b) Whether the component auditor has complied with the group engagement team's requirements;
  - (c) Identification of the financial information of the component on which the component auditor is reporting;
  - (d) Information on instances of non-compliance with laws or regulations that could give rise to a material misstatement of the group financial report;
  - (e) A list of uncorrected misstatements of the financial information of the component (the list need not include misstatements that are below the threshold for clearly trivial misstatements communicated by the group engagement team, see paragraph 40(c));
  - (f) Indicators of possible management bias;
  - (g) Description of any identified material weaknesses in internal control over financial reporting at the component level;
  - (h) Other significant matters that the component auditor communicated or expects to communicate to those charged with governance of the component, including fraud or suspected fraud involving component management, employees who have significant roles in internal control at the component level or others where the fraud resulted in a material misstatement of the financial information of the component;

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

- (i) Any other matters that may be relevant to the group audit, or that the component auditor wishes to draw to the attention of the group engagement team, including exceptions noted in the written representations that the component auditor requested from component management; and
- (j) The component auditor's overall findings, conclusions or opinion.

**Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

*Evaluating the Component Auditors' Communication and Adequacy of their Work*

42. The group engagement team shall evaluate the component auditor's communication, see paragraph 41. The group engagement team shall:
- (a) Discuss significant matters arising from that evaluation with the component auditor, component management or group management, as appropriate; and
  - (b) Determine whether it is necessary to review other relevant parts of the component auditor's audit documentation. (Ref: Para. A61)
43. If the group engagement team concludes that the work of the component auditor is insufficient, the group engagement team shall determine what additional procedures are to be performed, and whether they are to be performed by the component auditor or by the group engagement team.

*Sufficiency and Appropriateness of Audit Evidence*

44. The auditor is required to obtain sufficient appropriate audit evidence on which to base the audit opinion [see ASA 200 (Revised and Redrafted)].<sup>10</sup> The group engagement team shall evaluate whether sufficient appropriate audit evidence has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team and the

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<sup>10</sup> Deleted by the AUASB

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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component auditors on the financial information of the components, on which to base the group audit opinion. (Ref: Para. A62)

45. The group engagement partner shall evaluate the effect on the group audit opinion of any uncorrected misstatements (either identified by the group engagement team or communicated by component auditors) and any instances where there has been an inability to obtain sufficient appropriate audit evidence. (Ref: Para. A63)

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

*Communication with Group Management*

46. The group engagement team shall make group management aware, on a timely basis and at an appropriate level of responsibility, of:
- (a) Material weaknesses in the design or operating effectiveness of group-wide controls;
  - (b) Material weaknesses that the group engagement team has identified in internal controls at components and judges are of significance to the group; and
  - (c) Material weaknesses that component auditors have identified in internal controls at components and brought to the attention of the group engagement team that the group engagement team judges are of significance to the group.
47. If fraud has been identified by the group engagement team or brought to its attention by a component auditor, see paragraph 41(h), or information indicates that a fraud may exist, the group engagement team shall 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 fraud of matters relevant to their responsibilities. (Ref: Para. A64)
48. A component auditor may be required by statute, regulation or for another reason, to express an audit opinion on the financial report of a component. In that case, the group engagement team shall request group management to inform component management of any matter of which the group engagement team becomes aware that may be significant to the financial report of the component, but of which component management may be unaware. If group management refuses to communicate the matter to component management, the

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

group engagement team shall discuss the matter with those charged with governance of the group. If the matter remains unresolved, the group engagement team, subject to legal and professional confidentiality considerations, shall consider whether to advise the component auditor not to issue the auditor's report on the financial report of the component until the matter is resolved. (Ref: Para. A65)

*Communication with Those Charged with Governance of the Group*

49. The group engagement team shall communicate the following matters with those charged with governance of the group, in addition to those required by ASA 260 (Revised and Redrafted) [see ASA 260 (Revised and Redrafted) *Communication with Those Charged with Governance*]<sup>11</sup> and other Auditing Standards: (Ref: Para. A66)

- (a) An overview of the type of work to be performed on the financial information of the components.
- (b) An overview of the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components.
- (c) Instances where the group engagement team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work.
- (d) Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted.
- (e) Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial report.

**Reporting Considerations**

Aus 49.1 Where a component auditor issues, or intends to issue, a modified auditor's report, the group engagement partner shall consider:

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<sup>11</sup> Deleted by the AUASB

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- (a) The nature and significance of the modification, in relation to the financial report of the entity on which the group engagement partner is reporting; and
- (b) Whether a modification is also required to the group engagement partner's report, under *ASA 705 Modifications to the Opinion in the Independent Auditor's Report (Revised and Redrafted)*.

**Documentation**

50. In meeting the documentation requirements in ASA 230 (Revised and Redrafted) [see ASA 230 (Revised and Redrafted) *Audit Documentation*]<sup>12</sup> and other Auditing Standards, the group engagement team shall also document the following matters:
- (a) An analysis of components, indicating those that are significant, and the type of work performed on the financial information of the components.
  - (b) The nature, timing and extent of the group engagement team's involvement in the work performed by the component auditors on significant components including, where applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon.
  - (c) Written communications between the group engagement team and the component auditors about the group engagement team's requirements.

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<sup>12</sup> Deleted by the AUASB.

## **Application and Other Explanatory Material**

### **Components Subject to Audit by Statute, Regulation or Other Reason**

(Ref: Para. 3)

- A1. Factors that may affect the group engagement team's decision whether to use an audit required by statute, regulation or for another reason to provide audit evidence for the group audit include the following:
- Differences in the financial reporting framework applied in preparing the financial report of the component and that applied in preparing the group financial report.
  - Differences in the auditing and other standards applied by the component auditor and those applied in the audit of the group financial report.
  - Whether the audit of the financial report of the component will be completed in time to meet the group reporting timetable.

### **Definitions**

*Component* (Ref: Para. 9(a))

- A2. The structure of a group affects how components are identified. For example, the group financial reporting system may be based on an organisational structure that provides for financial information to be prepared by a parent and one or more subsidiaries, joint ventures, or investees accounted for by the equity or cost methods of accounting; by a head office and one or more divisions or branches; or by a combination of both. Some groups, however, may organise their financial reporting system by function, process, product or service (or by groups of products or services), or geographical locations. In these cases, the entity or business activity for which group or component management prepares financial information that is included in the group financial report may be a function, process, product or service (or group of products or services), or geographical location.
- A3. Various levels of components may exist within the group financial reporting system, in which case it may be more appropriate to

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

identify components at certain levels of aggregation rather than individually.

- A4. Components aggregated at a certain level may constitute a component for purposes of the group audit; however, such a component may also prepare a group financial report that incorporate the financial information of the components it encompasses (i.e., a subgroup). This Auditing Standard may therefore be applied by different group engagement partners and teams for different subgroups within a larger group.

*Significant Component* (Ref: Para. 9(m))

- A5. As the individual financial significance of a component increases, the risks of material misstatement of the group financial report ordinarily increase. The group engagement team may apply a percentage to a chosen benchmark as an aid to identify components that are of individual financial significance. Identifying a benchmark and determining a percentage to be applied to it involve the exercise of professional judgement. Depending on the nature and circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, profit or turnover. For example, the group engagement team may consider that components exceeding 15% of the chosen benchmark are significant components. A higher or lower percentage may, however, be deemed appropriate in the circumstances.
- A6. The group engagement team may also identify a component as likely to include significant risks of material misstatement of the group financial report due to its specific nature or circumstances (i.e., risks that require special audit consideration<sup>13</sup>). For example, a component could be responsible for foreign exchange trading and thus expose the group to a significant risk of material misstatement, even though the component is not otherwise of individual financial significance to the group.

*Component Auditor* (Ref: Para. 9(b))

- A7. A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. Where this is the case, such a member of the engagement team is also a component auditor.

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<sup>13</sup> See ASA 315 (Revised and Redrafted), paragraphs 26-28.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

**Responsibility** (Ref: Para. 11)

- A8. Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings, conclusions or opinions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.
- A9. When the group audit opinion is modified because the group engagement team was unable to obtain sufficient appropriate audit evidence in relation to the financial information of one or more components, under ASA 705 (Revised and Redrafted), the Basis for Modification paragraph in the auditor's report on the group financial report describes the reasons for that inability without referring to the component auditor, unless such a reference is necessary for an adequate explanation of the circumstances.<sup>14</sup>

**Acceptance and Continuance**

*Obtaining an Understanding at the Acceptance or Continuance Stage* (Ref: Para. 12)

- A10. In the case of a new engagement, the group engagement team's understanding of the group, its components, and their environments may be obtained from:
- Information provided by group management;
  - Communication with group management; and
  - Where applicable, communication with the previous group engagement team, component management, or component auditors.
- A11. The group engagement team's understanding may include matters such as the following:
- The group structure, including both the legal and organisational structure (i.e., how the group financial reporting system is organised).

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<sup>14</sup> See ASA 705 (Revised and Redrafted), paragraph 22.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- Components' business 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 organisations, including shared service centres.
  - A description of group-wide controls.
  - The complexity of the consolidation process.
  - Whether component auditors that are not from the group engagement partner's firm or network will perform work on the financial information of any of the components, and group management's rationale for appointing more than one auditor.
  - Whether the group engagement team:
    - Will have unrestricted access to those charged with governance of the group, group management, those charged with governance of the component, component management, component information, and the component auditors (including relevant audit documentation sought by the group engagement team); and
    - Will be able to perform necessary work on the financial information of the components.
- A12. In the case of a continuing engagement, the group engagement team's ability to obtain sufficient appropriate audit evidence may be affected by significant changes, for example:
- Changes in the group structure (e.g., acquisitions, disposals, reorganisations, or changes in how the group financial reporting system is organised).
  - Changes in components' business activities that are significant to the group.
  - Changes in the composition of those charged with governance of the group, group management, or key management of significant components.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

- Concerns the group engagement team has with regard to the integrity and competence of group or component management.
- Changes in group-wide controls.
- Changes in the applicable financial reporting framework.

Aus A12.1 Section 323B of the *Corporations Act 2001* provides that the auditor of a controlled (component) entity must give the principal (group) auditor any information, explanation or assistance required under section 323A.

*Expectation to Obtain Sufficient Appropriate Audit Evidence* (Ref: Para. 13)

A13. A group may consist only of components not considered significant components. In these circumstances, the group engagement partner can reasonably expect to obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team will be able to:

- (a) Perform the work on the financial information of some of these components; and
- (b) Be involved in the work performed by component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.

*Access to Information* (Ref: Para. 13)

A14. The group engagement team's access to information may be restricted by circumstances that cannot be overcome by group management, for example laws relating to confidentiality and data privacy, or denial by the component auditor of access to relevant audit documentation sought by the group engagement team. It may also be restricted by group management.

A15. Where access to information is restricted by circumstances, the group engagement team may still be able to obtain sufficient appropriate audit evidence; however, this is less likely as the significance of the component increases. For example, the group engagement team may not have access to those charged with governance, management, or the auditor (including relevant audit documentation sought by the group engagement team) of a

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

component that is accounted for by the equity method of accounting. If the component is not a significant component, and the group engagement team has a financial report of the component, including the auditor's report thereon, and has access to information kept by group management in relation to that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence in relation to that component. If the component is a significant component, however, the group engagement team will not be able to comply with the requirements of this Auditing Standard relevant in the circumstances of the group audit. For example, the group engagement team will not be able to comply with the requirement in paragraphs 30-31 to be involved in the work of the component auditor. The group engagement team will not, therefore, be able to obtain sufficient appropriate audit evidence in relation to that component. The effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of ASA 705 (Revised and Redrafted).

- A16. The group engagement team will not be able to obtain sufficient appropriate audit evidence if group management restricts the access of the group engagement team or a component auditor to the information of a significant component.
- A17. Although the group engagement team may be able to obtain sufficient appropriate audit evidence if such restriction relates to a component considered not a significant component, the reason for the restriction may affect the group audit opinion. For example, it may affect the reliability of group management's responses to the group engagement team's enquiries and group management's representations to the group engagement team.
- A18. Law or regulation may prohibit the group engagement partner from declining or resigning from an engagement. For example, in some cases the auditor is appointed for a specified period of time and is prohibited from resigning before the end of that period. Also, in the public sector, the option of declining or resigning from an engagement may not be available to the auditor due to the nature of the mandate or public interest considerations. In these circumstances, this Auditing Standard still applies to the group audit, and the effect of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of ASA 705 (Revised and Redrafted).

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

A19. Appendix 1 contains an example of an auditor's report containing a qualified opinion based on the group engagement team's inability to obtain sufficient appropriate audit evidence in relation to a significant component accounted for by the equity method of accounting, but where, in the group engagement team's judgement, the effect is material but not pervasive.

*Terms of Engagement* (Ref: Para. 14)

A20. The terms of engagement identifies the applicable financial reporting framework.<sup>15</sup> Additional matters may be included in the terms of a group audit engagement, such as the fact that:

- The communication between the group engagement team and the component auditors should be unrestricted to the extent permitted by law or regulation.
- Important communications between the component auditors, those charged with governance of the component, and component management, including communications on material weaknesses in internal control, should be communicated as well to the group engagement team.
- Important communications between regulatory authorities and components related to financial reporting matters should be communicated to the group engagement team.
- To the extent the group engagement team considers necessary, it should be permitted:
  - Access to component information, those charged with governance of components, component management, and the component auditors (including relevant audit documentation sought by the group engagement team); and
  - To perform work or request a component auditor to perform work on the financial information of the components.

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<sup>15</sup> See ASA 210 (Revised and Redrafted), (amended as a result of ASA 700 (Revised and Redrafted), paragraph 10).

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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A21. Restrictions imposed on:

- the group engagement team's access to component information, those charged with governance of components, component management, or the component auditors (including relevant audit documentation sought by the group engagement team); or
- the work to be performed on the financial information of the components,

after the group engagement partner's acceptance of the group audit engagement, constitute an inability to obtain sufficient appropriate audit evidence that may affect the group audit opinion. In exceptional circumstances it may even lead to resignation from the engagement where that is not prohibited by law or regulation.

**Overall Audit Strategy and Audit Plan** (Ref: Para. 16)

A22. The group engagement partner's review of the overall group audit strategy and group audit plan is an important part of fulfilling the group engagement partner's responsibility for the direction of the group audit engagement.

**Understanding the Group, Its Components and Their Environments**

*Matters About Which the Group Engagement Team Obtains an Understanding* (Ref: Para. 17)

A23. ASA 315 (Revised and Redrafted)<sup>16</sup> contains guidance on matters the auditor may consider when obtaining an understanding of the industry, regulatory, and other external factors that affect the entity, including the applicable financial reporting framework; the nature of the entity; objectives and strategies and related business risks; and measurement and review of the entity's financial performance. Appendix 2 of this Auditing Standard contains guidance on matters specific to a group, including the consolidation process.

*Instructions Issued by Group Management to Components* (Ref: Para. 17)

A24. To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components. Such instructions specify the requirements for financial information

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<sup>16</sup> See ASA 315 (Revised and Redrafted), paragraphs A15-A37.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

of the components to be included in the group financial report and often include financial reporting procedures manuals and a reporting package. A reporting package ordinarily consists of standard formats for providing financial information for incorporation in the group financial report. Reporting packages generally do not, however, take the form of a financial report prepared and presented in accordance with the applicable financial reporting framework.

A25. The instructions ordinarily cover:

- The accounting policies to be applied;
- Statutory and other disclosure requirements applicable to the group financial report, including:
  - The identification and reporting of segments;
  - Related party relationships and transactions;
  - Intra-group transactions and unrealised profits;
  - Intra-group account balances; and
- A reporting timetable.

A26. The group engagement team's understanding of the instructions may include the following:

- The clarity and practicality of the instructions for completing the reporting package.
- Whether the instructions:
  - Adequately describe the characteristics of the applicable financial reporting framework;
  - Provide for 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;
  - Provide for the identification of consolidation adjustments, for example intra-group transactions

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- and unrealised profits, and intra-group account balances; and
- Provide for the approval of the financial information by component management.

*Fraud* (Ref: Para. 17)

A27. The auditor is required to identify and assess the risks of material misstatement of the financial report due to fraud, and to design and implement appropriate responses to the assessed risks.<sup>17</sup> Information used to identify the risks of material misstatement of the group financial report due to fraud may include the following:

- Group management’s assessment of the risks that the group financial report may be materially misstated as a result of fraud.
- Group management’s process for identifying and responding to the risks of fraud in the group, including any specific fraud risks identified by group management, or account balances, classes of transactions, or disclosures for which a risk of fraud is likely.
- Whether there are particular components for which a risk of fraud is likely.
- How those charged with governance of the group monitor group management’s processes 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, internal audit (and if considered appropriate, component management, the component auditors, and others) to the group engagement team’s enquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group.

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<sup>17</sup> See ASA 240 (Revised and Redrafted), “*The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Reports.*”

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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*Discussion among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Report, Including Risks of Fraud* (Ref: Para. 17)

- A28. The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial reports due to fraud or error, specifically emphasising the risks due to fraud. In a group audit, these discussions may also include the component auditors.<sup>18</sup> The group engagement partner's determination of who to include in the discussions, how and when they occur, and their extent, is affected by factors such as prior experience with the group.
- A29. The discussions provide an opportunity to:
- Share knowledge of the components and their environments, including group-wide controls.
  - Exchange information about the business risks of the components or the group.
  - Exchange ideas about how and where the group financial report may be susceptible to material misstatement due to fraud or error, how group management and component management could perpetrate and conceal fraudulent financial reporting, and how assets of the components could be misappropriated.
  - Identify practices followed by group or component management that may be biased or designed to manage earnings that could lead to fraudulent financial reporting, for example revenue recognition practices that do not comply with the applicable financial reporting framework.
  - 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 rationalise committing fraud.

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<sup>18</sup> See ASA 240 (Revised and Redrafted), paragraph 15, and ASA 315 (Revised and Redrafted), paragraph 10.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- Consider the risk that group or component management may override controls.
- Consider whether uniform accounting policies are used to prepare the financial information of the components for the group financial reports and, where not, how differences in accounting policies are identified and adjusted (where required by the applicable financial reporting framework).
- Discuss fraud that has been identified in components, or information that indicates existence of a fraud in a component.
- Share information that may indicate non-compliance with national laws or regulations, for example payments of bribes and improper transfer pricing practices.

*Risk Factors* (Ref: Para. 18)

- A30. Appendix 3 sets out examples of conditions or events that, individually or together, may indicate risks of material misstatement of the group financial report, including risks due to fraud.

*Risk Assessment* (Ref: Para. 18)

- A31. The group engagement team's assessment at group level of the risks of material misstatement of the group financial report is based on information such as the following:
- Information obtained from the understanding of the group, its components, and their environments, and of the consolidation process, including audit evidence obtained in evaluating the design and implementation of group-wide controls and controls that are relevant to the consolidation.
  - Information obtained from the component auditors.

**Understanding the Component Auditors** (Ref: Para. 19-20)

- A32. The group engagement team obtains an understanding of a component auditor only when it plans to request the component auditor to perform work on the financial information of a component for the group audit. For example, it will not be necessary to obtain an understanding of the auditors of those components for which the

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

group engagement team plans to perform analytical procedures at group level only.

*Group Engagement Team's Procedures to Obtain an Understanding of the Component Auditor and Sources of Audit Evidence* (Ref: Para. 19)

A33. The nature, timing and extent of the group engagement team's procedures to obtain an understanding of the component auditor are affected by factors such as previous experience with or knowledge of the component auditor, and the degree to which the group engagement team and the component auditor are subject to common policies and procedures, for example:

- Whether the group engagement team and a component auditor share:
  - Common policies and audit procedures for performing the work (e.g., audit methodologies);
  - Common quality control policies and procedures; or
  - Common monitoring policies and procedures.
- The consistency or similarity of:
  - Laws and regulations or legal system;
  - Professional oversight, discipline, and external quality assurance;
  - Education and training;
  - Professional organisations and standards; and
  - Language and culture.

A34. These factors interact and are not mutually exclusive. For example, the extent of the group engagement team's procedures to obtain an understanding of Component Auditor A, who consistently applies common quality control and monitoring policies and procedures and a common audit methodology or operates in the same jurisdiction as the group engagement partner, may be less than the extent of the group engagement team's procedures to obtain an understanding of Component Auditor B, who is not consistently applying common

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

quality control and monitoring policies and procedures and a common audit methodology or operates in a foreign jurisdiction. The nature of the procedures performed in relation to Component Auditors A and B may also be different.

A35. The group engagement team may obtain an understanding of the component auditor in a number of ways. In the first year of involving a component auditor, the group engagement team may, for example:

- Evaluate the results of the quality control monitoring system where the group engagement team and component auditor are from a firm or network that operates under and complies with common monitoring policies and procedures;<sup>19</sup>
- Visit the component auditor to discuss the matters in paragraph 19(a)-(c);
- Request the component auditor to confirm the matters referred to in paragraph 19(a)-(c) in writing. Appendix 4 contains an example of written confirmations by a component auditor;
- Request the component auditor to complete questionnaires about the matters in paragraph 19(a)-(c);
- Discuss the component auditor with colleagues in the group engagement partner's firm, or with a reputable third party that has knowledge of the component auditor; or
- Where not prohibited by laws or regulations, obtain confirmations of credentials, \* from the professional body or bodies to which the component auditor belongs, the authorities by which the component auditor is licensed, or other third parties.

In subsequent years, the understanding of the component auditor may be based on the group engagement team's previous experience with the component auditor. The group engagement team may request the component auditor to confirm whether anything in

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<sup>19</sup> See APES 320 *Quality Control for Firms* issued by the Accounting Professional and Ethical Standards Board.

\* Such as confirmation of membership of a professional body.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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relation to the matters listed in paragraph 19(a)-(c) has changed since the previous year.

- A36. Where independent oversight bodies have been established to oversee the auditing profession and monitor the quality of audits, awareness of the regulatory environment may assist the group engagement team in evaluating the independence and competence of the component auditor. Information about the regulatory environment may be obtained from the component auditor or information provided by the independent oversight bodies.

*Ethical Requirements that are Relevant to the Group Audit* (Ref: Para. 19(a))

- A37. When performing work on the financial information of a component for a group audit, the component auditor is subject to ethical requirements that are relevant to the group audit. Such requirements may be different or in addition to those applying to the component auditor when performing a statutory audit in the component auditor's jurisdiction. The group engagement team therefore obtains an understanding whether the component auditor understands and will comply with the ethical requirements that are relevant to the group audit, sufficient to fulfil the component auditor's responsibilities in the group audit.

*The Component Auditor's Professional Competence* (Ref: Para. 19(b))

- A38. The group engagement team's understanding of the component auditor's professional competence may include whether the component auditor:
- Possesses an understanding of auditing and other standards applicable to the group audit that is sufficient to fulfill the component auditor's responsibilities in the group audit;
  - Possesses the special skills (e.g., industry specific knowledge) necessary to perform the work on the financial information of the particular component; and
  - Where relevant, possesses an understanding of the applicable financial reporting framework that is sufficient to fulfill the component auditor's responsibilities in the group audit (instructions issued by group management to components often describe the characteristics of the applicable financial reporting framework).

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

*Application of the Group Engagement Team's Understanding of a Component Auditor* (Ref: Para. 20)

- A39. The group engagement team cannot overcome the fact that a component auditor is not independent by being involved in the work of the component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.
- A40. However, the group engagement team may be able to overcome less than serious concerns about the component auditor's professional competency (e.g., lack of industry specific knowledge), or the fact that the component auditor does not operate in an environment that actively oversees auditors, by being involved in the work of the component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.
- A41. Where law or regulation prohibits access to relevant parts of the audit documentation of the component auditor, the group engagement team may request the component auditor to overcome this by preparing a memorandum that covers the relevant information.

**Materiality** (Ref: Para. 21-23)

- A42. Under paragraph 21, the auditor is required:<sup>20</sup>
- (a) When establishing the overall audit strategy, to determine a materiality level for the financial report as a whole.
  - (b) When establishing the overall audit strategy, to consider whether, in the specific circumstances of the entity, there are particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality level for the financial report as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial report. In such circumstances, the auditor determines the materiality levels to be applied to those particular classes of transactions, account balances or disclosures.

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<sup>20</sup> See ASA 320 (Revised and Redrafted), "Materiality in Planning and Performing an Audit," paragraphs 9-11.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- (c) To determine one or more amounts lower than the materiality level for the financial report as a whole for purposes of assessing the risks of material misstatement and designing further audit procedures to respond to assessed risks.

In the context of a group audit, materiality levels are established for both the group financial report as a whole, and for the financial information of the components. The materiality level for the group financial report as a whole is used when establishing the overall group audit strategy.

- A43. To reduce the risk that the aggregate of detected and undetected misstatements in the group financial report exceeds the materiality level for the group financial report as a whole, the component materiality level is set lower than the group materiality level. Different materiality levels may be established for different components. The component materiality level need not be an arithmetical portion of the group materiality level and, consequently, the aggregate of the component materiality levels may exceed the group materiality level. The component materiality level is used when establishing the overall audit strategy for a component.
- A44. Component materiality levels are determined for those components whose financial information will be audited or reviewed as part of the group audit in accordance with paragraphs 26, 27(a) and 29. Component materiality is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate.
- A45. A threshold for misstatements is determined in addition to the component materiality levels. Misstatements identified in the financial information of the component that are above the threshold for misstatements are communicated to the group engagement team.
- A46. In the case of an audit of the financial information of a component, the component auditor (or group engagement team) determines one or more amounts lower than the component materiality level for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks.<sup>21</sup> This is necessary to reduce the risk that the aggregate of detected and undetected misstatements in the financial information of the component exceeds

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<sup>21</sup> See ASA 320 (Revised and Redrafted), paragraph 11.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

the component materiality level. In practice, the group engagement team may set component materiality at this lower level. Where this is the case, the component auditor uses component materiality for purposes of assessing the risks of material misstatement of the financial information of the component and to design further audit procedures in response to assessed risks as well as for evaluating whether detected misstatements are material individually or in the aggregate.

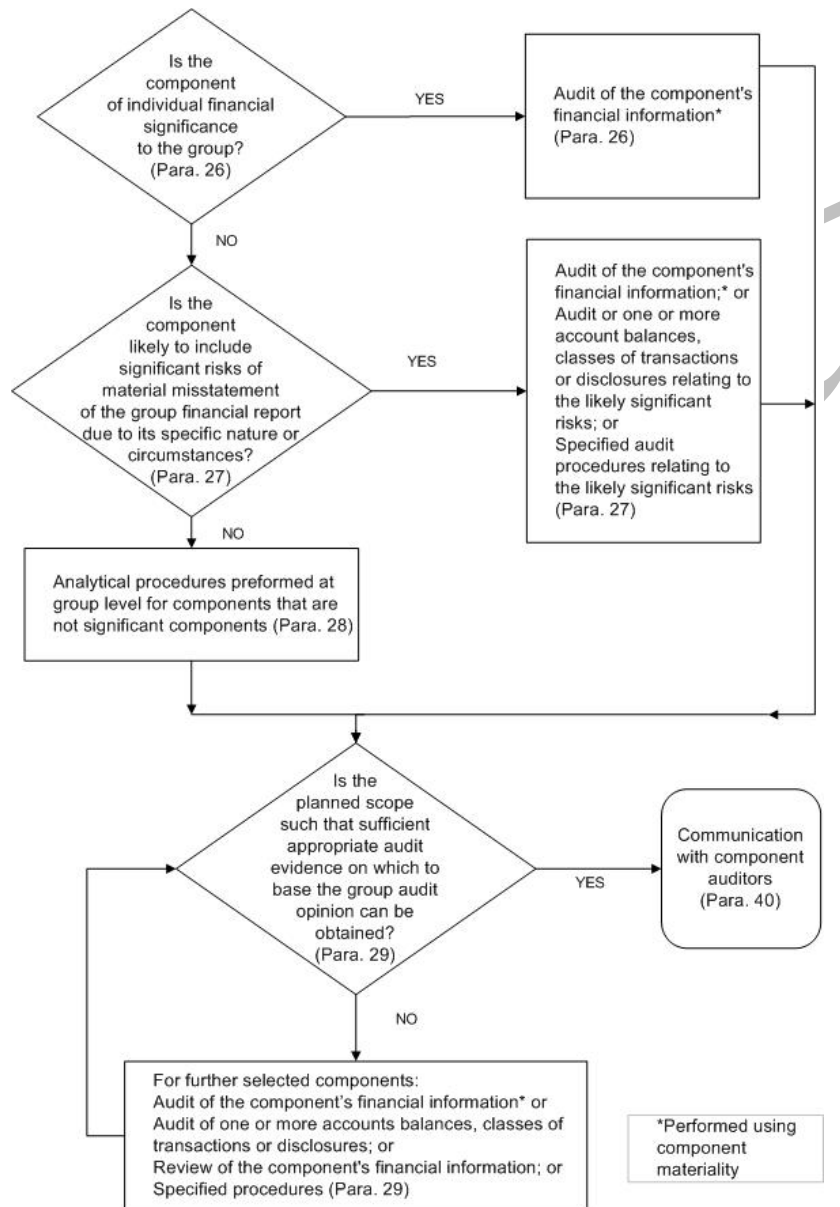
**Responding to Assessed Risks**

*Determining the Type of Work to be Performed on the Financial Information of Components* (Ref: Para. 26-27)

- A47. The group engagement team's determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by:
- (a) The significance of the component;
  - (b) The identified significant risks of material misstatement of the group financial report;
  - (c) The group engagement team's evaluation of the design of group-wide controls and determination whether they have been implemented; and
  - (d) The group engagement team's understanding of the component auditor.

The following diagram shows how the significance of the component affects the group engagement team's determination of the type of work to be performed on the financial information of the component.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors)*** (Revised and Redrafted)



**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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Significant Components (Ref: Para. 27(b)-(c))

- A48. The group engagement team may identify a component as a significant component because that component is likely to include significant risks of material misstatement of the group financial report due to its specific nature or circumstances. In that case, the group engagement team may be able to identify the account balances, classes of transactions or disclosures affected by the likely significant risks. Where this is the case, the group engagement team may decide to perform, or request a component auditor to perform, an audit of only those account balances, classes of transactions or disclosures. For example, in the situation described in paragraph A6, the work on the financial information of the component may be limited to an audit of the account balances, classes of transactions and disclosures affected by the foreign exchange trading of that component. Where the group engagement team requests a component auditor to perform an audit of one or more specific account balances, classes of transactions or disclosures, the communication of the group engagement team (see paragraph 40) takes account of the fact that many financial report items are interrelated.
- A49. The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial report. For example, in the case of a likely significant risk of inventory obsolescence, the group engagement team may perform, or request a component auditor to perform, specified audit procedures on the valuation of inventory at a component that holds a large volume of potentially obsolete inventory, but that is not otherwise significant.

Components that are Not Significant Components (Ref: Para. 28-29)

- A50. Depending on the circumstances of the engagement, the financial information of the components may be aggregated at various levels for purposes of the analytical procedures. The results of the analytical procedures corroborate the group engagement team's conclusions that there are no significant risks of material misstatement of the aggregated financial information of components that are not significant components.
- A51. The group engagement team's decision as to how many components to select in accordance with paragraph 29, which components to select, and the type of work to be performed on the financial

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

information of the individual components selected may be affected by factors such as the following:

- The extent of audit evidence expected to be obtained on the financial information of the significant components.
- Whether the component has been newly formed or acquired.
- Whether significant changes have taken place in the component.
- Whether internal audit has performed work at the component and any effect of that work on the group audit.
- Whether the components apply common systems and processes.
- The operating effectiveness of group-wide controls.
- Abnormal fluctuations identified by analytical procedures performed at group level.
- The individual financial significance of, or the risk posed by, the component in comparison with other components within this category.
- Whether the component is subject to audit required by statute, regulation or for another reason.

Including an element of unpredictability in selecting components in this category may increase the likelihood of identifying material misstatement of the components' financial information. The selection of components is often varied on a cyclical basis.

- A52. A review of the financial information of a component may be performed in accordance with ASRE 2400<sup>22</sup>, ASRE 2405\* or ASRE 2410<sup>23</sup>. The group engagement team may also specify additional audit procedures to supplement this work.

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<sup>22</sup> ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity*.

\* ASRE 2405 *Review of Historical Financial Information Other than a Financial Report*.

<sup>23</sup> ASRE 2410 *Review of Interim and Other Financial Reports Performed by the Independent Auditor of the Entity* (Revised and Redrafted).

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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A53. As explained in paragraph A13, a group may consist only of components that are not significant components. In these circumstances, the group engagement team can obtain sufficient appropriate audit evidence on which to base the group audit opinion by determining the type of work to be performed on the financial information of the components in accordance with paragraph 29. It is unlikely that the group engagement team will obtain sufficient appropriate audit evidence on which to base the group audit opinion if the group engagement team, or a component auditor, only tests group-wide controls and performs analytical procedures on the financial information of the components.

*Involvement in the Work Performed by Component Auditors* (Ref: Para. 30-31)

A54. Factors that may affect the group engagement team's involvement in the work of the component auditor include:

- (a) The significance of the component;
- (b) The identified significant risks of material misstatement of the group financial report; and
- (c) The group engagement team's understanding of the component auditor.

In the case of a significant component or identified significant risks, the group engagement team performs the procedures described in paragraphs 30-31. In the case of a component that is not a significant component, the nature, timing and extent of the group engagement team's involvement in the work of the component auditor will vary based on the group engagement team's understanding of that component auditor. The fact that the component is not a significant component becomes secondary. For example, even though a component is not considered a significant component, the group engagement team nevertheless may decide to be involved in the component auditor's risk assessment, because it has less than serious concerns about the component auditor's professional competency (e.g., lack of industry specific knowledge), or the component auditor does not operate in an environment that actively oversees auditors.

A55. Forms of involvement in the work of a component auditor other than those described in paragraphs 30-31 and 42 may, based on the group engagement team's understanding of the component auditor, include one or more of the following:

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- (a) Meeting with component management or the component auditors to obtain an understanding of the component and its environment.
- (b) Reviewing the component auditors' overall audit strategy and audit plan.
- (c) Performing risk assessment procedures to identify and assess the risks of material misstatement at the component level. These may be performed with the component auditors, or by the group engagement team.
- (d) Designing and performing further audit procedures. These may be designed and performed with the component auditors, or by the group engagement team.
- (e) Participating in the closing and other key meetings between the component auditors and component management.
- (f) Reviewing other relevant parts of the component auditors' audit documentation.

**Consolidation Process**

*Consolidation Adjustments and Reclassifications* (Ref: Para. 34)

A56. The consolidation process may require adjustments to amounts reported in the group financial report that do not pass through the usual transaction processing systems, and may not be subject to the same internal controls to which other financial information is subject. The group engagement team's evaluation of the appropriateness, completeness and accuracy of the adjustments may include:

- Evaluating whether significant adjustments appropriately reflect the events and transactions underlying them;
- Determining whether significant adjustments have been correctly calculated, processed and authorised by group management and, where applicable, by component management;
- Determining whether significant adjustments are properly supported and sufficiently documented; and

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

- Checking the reconciliation and elimination of intra-group transactions and unrealised profits, and intra-group account balances.

**Communication with the Component Auditor** (Ref: Para. 40-41)

- A57. If effective two-way communication between the group engagement team and the component auditors does not exist, there is a risk that the group engagement team may not obtain sufficient appropriate audit evidence on which to base the group audit opinion. Clear and timely communication of the group engagement team's requirements forms the basis of effective two-way communication between the group engagement team and the component auditor.
- A58. The group engagement team's requirements are often communicated in a letter of instruction. Appendix 5 contains guidance on required and additional matters that may be included in such a letter of instruction. The component auditor's communication with the group engagement team often takes the form of a memorandum or report of work performed. Communication between the group engagement team and the component auditor, however, may not necessarily be in writing. For example, the group engagement team may visit the component auditor to discuss identified significant risks or review relevant parts of the component auditor's audit documentation. Nevertheless, the documentation requirements of this and other Auditing Standards apply.
- A59. In cooperating with the group engagement team, the component auditor, for example, would provide the group engagement team with access to relevant audit documentation if not prohibited by law or regulation.
- A60. Where a member of the group engagement team is also a component auditor, the objective for the group engagement team to communicate clearly with the component auditor can often be achieved by means other than specific written communication. For example:
- Access by the component auditor to the overall audit strategy and audit plan may be sufficient to communicate the group engagement team's requirements set out in paragraph 40; and
  - A review of the component auditor's audit documentation by the group engagement team may be sufficient to

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

---

communicate matters relevant to the group engagement team's conclusion set out in paragraph 41.

**Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained**

*Reviewing the Component Auditor's Audit Documentation* (Ref: Para. 42(b))

- A61. What parts of the audit documentation of the component auditor will be relevant to the group audit may vary depending on the circumstances. Often the focus is on audit documentation that is relevant to the significant risks of material misstatement of the group financial report. The extent of the review may be affected by the fact that the component auditor's audit documentation has been subjected to the component auditor's firm's review procedures.

*Sufficiency and Appropriateness of Audit Evidence* (Ref: Para. 44-45)

- A62. If the group engagement team concludes that sufficient appropriate audit evidence on which to base the group audit opinion has not been obtained, the group engagement team may request the component auditor to perform additional procedures. If this is not feasible, the group engagement team may perform its own procedures on the financial information of the component.
- A63. The group engagement partner's evaluation of the aggregate effect of any misstatements (either identified by the group engagement team or communicated by component auditors) allows the group engagement partner to determine whether the group financial report as a whole is materially misstated.

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

*Communication with Group Management* (Ref: Para. 46-48)

- A64. ASA 240 (Revised and Redrafted)<sup>24</sup> contains requirements and guidance on communication of fraud to management and, where management may be involved in the fraud, to those charged with governance.
- A65. Group management may need to keep certain material sensitive information confidential. Examples of matters that may be

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<sup>24</sup> See ASA 240 (Revised and Redrafted), paragraphs 40-42.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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significant to the financial report 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.

Aus A65.1 In the public sector, group management may not be readily identifiable at the whole of government level. Furthermore, responsibility for internal control may remain at individual entity level only. In such cases, the auditor determines the appropriate level of management with whom to communicate.

*Communication with Those Charged with Governance of the Group* (Ref: Para. 49)

A66. The matters the group engagement team communicates to those charged with governance of the group may include those brought to the attention of the group engagement team by component auditors that the group engagement team judges to be significant to the responsibilities of those charged with governance of the group. Communication with those charged with governance of the group takes place at various times during the group audit. For example, the matters referred to in paragraph 49(a)-(b) may be communicated after the group engagement team has determined the work to be performed on the financial information of the components. On the other hand, the matter referred to in paragraph 49(c) may be communicated at the end of the audit, and the matters referred to in paragraph 49(d)-(e) may be communicated when they occur.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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**Conformity with International Standards on Auditing**

This Auditing Standard conforms with International Standard on Auditing ISA 600 *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, issued by the International Auditing and Assurance Standards Board (IAASB), an independent standard-setting board of the International Federation of Accountants (IFAC).

Paragraphs that have been added to this Auditing Standard (and do not appear in the text of the equivalent ISA) are identified with the prefix “Aus”.

Compliance with this Auditing Standard enables compliance with ISA 600.

## **Appendix 1**

(Ref: Para. A19)

### **AUASB Information Note**

The example auditor's report in this Appendix will be amended to conform with ASA 705 *Modifications to the Opinion in the Independent Auditor's Report* (Revised and Redrafted) when that Auditing Standard has been approved by the AUASB. Accordingly, the AUASB does not expect respondents to this Exposure Draft to comment on this example auditor's report unless there are substantive issues that respondents wish to bring to the attention of the AUASB.

### **Example of a Qualified Opinion where the Group Engagement Team is Not Able to Obtain Sufficient Appropriate Audit Evidence on which to Base the Group Audit Opinion**

In this example, the group engagement team is unable to obtain sufficient appropriate audit evidence relating to a significant component accounted for by the equity method (recognised at \$15 million in the balance sheet, which reflects total assets of \$60 million) because the group engagement team did not have access to the accounting records, management, or auditor of the component.

The group engagement team has read the audited financial report of the component as of December 31, 20X1, including the auditor's report thereon, and considered related financial information kept by group management in relation to the component.

In the group engagement partner's judgement, the effect on the group financial report of this inability to obtain sufficient appropriate audit evidence is material but not pervasive.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

**Report on the Consolidated Financial Statements<sup>25</sup>**

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 20X1, and the consolidated income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation<sup>26</sup> of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining 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; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's

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<sup>25</sup> The sub-title "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second sub-title "Report on Other Legal and Regulatory Requirements" is not applicable.

<sup>26</sup> Depending on the circumstances, this sentence may read: "Management is responsible for the preparation and presentation of consolidated financial statements that give a true and fair view in accordance with International Financial Reporting Standards."

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation<sup>27</sup> of the consolidated financial statements 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 the entity's internal control.<sup>28</sup> An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

*Basis for Qualified Opinion*

ABC Company's investment in XYZ Company, a foreign associate acquired during the year and accounted for by the equity method, is carried at \$15 million on the consolidated balance sheet as at December 31, 20X1, and ABC's share of XYZ's net income of \$1 million is included in the consolidated income statement for the year then ended. We were unable to obtain sufficient appropriate audit evidence about the carrying amount of ABC's investment in XYZ as at December 31, 20X1 and ABC's share of XYZ's net income for the year because we were denied access to the financial information, management, and the auditors of XYZ. Consequently, we were unable to determine whether any adjustments to these amounts were necessary.

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<sup>27</sup> Depending on the circumstances, this sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of consolidated financial statements that give a true and fair view 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 the entity's internal control."

<sup>28</sup> In circumstances when 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, this sentence would be worded as follows: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances." In the case of footnote 27, the sentence may read: "In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and presentation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances."

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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*Qualified Opinion*

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the consolidated financial statements present fairly, in all material respects, (or “give a true and fair view of”) the financial position of ABC Company and its subsidiaries as of December 31, 20X1, and of their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor’s report will vary depending on the nature of the auditor’s other reporting responsibilities.]

[Auditor’s signature]

[Date of the auditor’s report]

[Auditor’s address]

If, in the group engagement partner’s judgement, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the group engagement partner would disclaim an opinion in accordance with ISA 705 (Revised and Redrafted).

## **Appendix 2**

(Ref: Para. A23)

### **Examples of Matters about which the Group Engagement Team Obtains an Understanding**

The examples provided cover a broad range of matters; however, not all matters are relevant to every group audit engagement and the list of examples is not necessarily complete.

#### **Group-wide Controls**

1. Group-wide controls may include a combination of the following:
  - Regular meetings between group and component management to discuss business developments and to review performance.
  - Monitoring of components' operations and their financial results, including regular reporting routines, which enables group management to monitor components' performance against budgets, and to take appropriate action.
  - Group management's risk assessment process, i.e., the process for identifying, analysing and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial report.
  - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealised profits, and intra-group account balances at group level.
  - A process for monitoring the timeliness and assessing the accuracy and completeness of financial information received from components.
  - A central IT system controlled by the same general IT controls for all or part of the group.
  - Control activities within an IT system that is common for all or some components.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- Monitoring of controls, including activities of internal audit and self-assessment programs.
  - Consistent policies and procedures, including a group financial reporting procedures manual.
  - Group-wide programs, such as codes of conduct and fraud prevention programs.
  - Arrangements for assigning authority and responsibility to component management.
2. Internal audit may be regarded as part of group-wide controls, for example, when the internal audit function is centralised. ASA 610 (Revised and Redrafted)<sup>29</sup> deals with the group engagement team's evaluation of the competence and objectivity of the internal auditors where it plans to use their work.

Consolidation Process

3. The group engagement team'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 component management has an understanding of the applicable financial reporting framework.
  - The process for identifying and accounting for components 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.

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<sup>29</sup> See ASA 610 (Revised and Redrafted), "The Auditor's Consideration of the Internal Audit Function," paragraph 8.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- The accounting policies applied to the group financial report, 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 components 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 components, and, where applicable, ensuring that uniform accounting policies are used to prepare the financial information of the components for the group financial report, and that differences in accounting policies are identified, and adjusted where 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 components 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 components for the consolidation.
- The process for translating the financial information of foreign components into the currency of the group financial report.
- How IT is organised for the consolidation, including the manual and automated stages of the process, and the manual and programmed controls in place at various stages of the consolidation process.
- Group management's process for obtaining information on subsequent events.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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Matters relating to consolidation adjustments:

- The process for recording consolidation adjustments, including the preparation, authorisation 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.
- Business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature and size of transactions between components.
- Procedures for monitoring, controlling, reconciling and eliminating intra-group transactions and unrealised profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortising goodwill (where 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 a component (for example, an obligation of the minority interest to make good such losses).

### **Appendix 3**

(Ref: Para. A30)

#### **Examples of Conditions or Events that may Indicate Risks of Material Misstatement of the Group Financial Report**

The examples provided cover a broad range of conditions or events; however, not all conditions or events are relevant to every group audit engagement and the list of examples is not necessarily complete.

- A complex group structure, especially where there are frequent acquisitions, disposals or reorganisations.
- Poor corporate governance structures, including decision-making processes, that are not transparent.
- Non-existent or ineffective group-wide controls, including inadequate group management information on monitoring of components' operations and their results.
- Components operating in foreign jurisdictions that may be exposed to factors such as unusual government intervention in areas such as trade and fiscal policy, and restrictions on currency and dividend movements; and fluctuations in exchange rates.
- Business activities of components that involve high risk, such as long-term contracts or trading in innovative or complex financial instruments.
- Uncertainties regarding which components' financial information require incorporation in the group financial report in accordance with the applicable financial reporting framework, for example whether any special-purpose entities or non-trading entities exist and require incorporation.
- Unusual related party relationships and transactions.
- Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.
- The existence of complex transactions that are accounted for in more than one component.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- Components' application of accounting policies that differ from those applied to the group financial report.
- Components with different financial year-ends, which may be utilised to manipulate the timing of transactions.
- Prior occurrences of unauthorised or incomplete consolidation adjustments.
- Aggressive tax planning within the group, or large cash transactions with entities in tax havens.
- Frequent changes of auditors engaged to audit the financial report of components.

## **Appendix 4**

(Ref: Para. A35)

### **Examples of a Component Auditor’s Confirmations**

The following is not intended to be a standard letter. Confirmations may vary from one component auditor to another and from one period to the next.

Confirmations often are obtained before work on the financial information of the component commences.

*[Component Auditor Letterhead]*

[Date]

[To Group Engagement Partner]

This letter is provided in connection with your audit of the group financial report of [name of parent] for the year ended [date] for the purpose of expressing an opinion on whether the group financial report presents fairly, in all material respects (gives a true and fair view of) the financial position of the group as of [date] and of its financial performance and cash flows for the year then ended in accordance with [indicate applicable financial reporting framework].

We acknowledge receipt of your instructions dated [date], requesting us to perform the specified work on the financial information of [name of component] for the year ended [date].

We confirm that:

1. We will be able to comply with the instructions. / We advise you that we will not be able to comply with the following instructions [specify instructions] for the following reasons [specify reasons].
2. The instructions are clear and we understand them. / We would appreciate it if you could clarify the following instructions [specify instructions].
3. We will cooperate with you and provide you with access to relevant audit documentation.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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We acknowledge that:

1. The financial information of [name of component] will be included in the group financial report of [name of parent].
2. You may consider it necessary to be involved in the work you have requested us to perform on the financial information of [name of component] for the year ended [date].
3. You intend to evaluate and, if considered appropriate, use our work for the audit of the group financial report of [name of parent].

In connection with the work that we will perform on the financial information of [name of component], a [describe component, e.g., wholly-owned subsidiary, subsidiary, joint venture, investee accounted for by the equity or cost methods of accounting] of [name of parent], we confirm the following:

1. We have an understanding of [indicate relevant ethical requirements] that is sufficient to fulfill our responsibilities in the audit of the group financial reports, and will comply therewith. In particular, and with respect to [name of parent] and the other components in the group, we are independent within the meaning of [indicate relevant ethical requirements] and comply with the applicable requirements of [refer to rules] promulgated by [name of regulatory agency].
2. We have an understanding of Australian Auditing Standards and [indicate other national standards applicable to the audit of the group financial report] that is sufficient to fulfill our responsibilities in the audit of the group financial report and will conduct our work on the financial information of [name of component] for the year ended [date] in accordance with those standards.
3. We possess the special skills (e.g., industry specific knowledge) necessary to perform the work on the financial information of the particular component.
4. We have an understanding of [indicate applicable financial reporting framework or group financial reporting procedures manual] that is sufficient to fulfill our responsibilities in the audit of the group financial report.

We will inform you of any changes in the above representations during the course of our work on the financial information of [name of component].

**Auditing Standard ASA 600**  
*Special Considerations – Audits of a Group Financial Report (Including  
the Work of Component Auditors) (Revised and Redrafted)*

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[Auditor's signature]

[Date]

[Auditor's address]

Draft

## **Appendix 5**

(Ref: Para. A58)

### **Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction**

***Matters required by this Auditing Standard to be communicated to the component auditor are shown in italicised text.***

Matters that are relevant to the planning of the work of the component auditor:

- *A request for the component auditor, knowing the context in which the group engagement team will use the work of the component auditor, to confirm that the component auditor will cooperate with the group engagement team.*
- The timetable for completing the audit.
- Dates of planned visits by group management and the group engagement team, and dates of planned meetings with component management and the component auditor.
- A list of key contacts.
- *The work to be performed by the component auditor, the use to be made of that work, and arrangements for coordinating efforts at the initial stage of and during the audit, including the group engagement team's planned involvement in the work of the component auditor.*
- *The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.*
- *In the case of an audit or review of the financial information of the component, component materiality, and the threshold above which misstatements cannot be regarded as clearly trivial to the group financial report.*
- *A list of related parties prepared by group management, and any other related parties that the group engagement team is aware of, and a request that the component auditor communicates on a timely basis to the group engagement team related parties not previously identified by group management or the group engagement team.*

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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- Work to be performed on intra-group transactions and unrealised profits and intra-group account balances.
- Guidance on other statutory reporting responsibilities, for example reporting on group management's assertion on the effectiveness of internal control.
- Where time lag between completion of the work on the financial information of the components and the group engagement team's conclusion on the group financial report is likely, specific instructions for a subsequent events review.

Matters that are relevant to the conduct of the work of the component auditor

- The findings of the group engagement team's tests of control activities of a processing system that is common for all or some components, and tests of controls to be performed by the component auditor.
- *Identified significant risks of material misstatement of the group financial report, due to fraud or error, that are relevant to the work of the component auditor, and a request that the component auditor communicates on a timely basis any other significant risks of material misstatement of the group financial report, due to fraud or error, identified in the component and the component auditor's response to such risks.*
- The findings of internal audit, based on work performed on controls at or relevant to components.
- A request for timely communication of audit evidence obtained from performing work on the financial information of the components that contradicts the audit evidence on which the group engagement team originally based the risk assessment performed at group level.
- A request for a written representation on component management's compliance with the applicable financial reporting framework, or a statement that differences between the accounting policies applied to the financial information of the component and those applied to the group financial report have been disclosed.
- Matters to be documented by the component auditor.

**Auditing Standard ASA 600**  
***Special Considerations – Audits of a Group Financial Report (Including the Work of Component Auditors) (Revised and Redrafted)***

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Other information

- A request that the following be reported to the group engagement team on a timely basis:
  - Significant accounting, financial reporting and auditing matters, including accounting estimates and related judgements.
  - Matters relating to the going concern status of the component.
  - Matters relating to litigation and claims.
  - Material weaknesses in controls that have come to the attention of the component auditor during the performance of the work on the financial information of the component, and information that indicates the existence of fraud.
- A request that the group engagement team be notified of any significant or unusual events as early as possible.
- *A request that the matters listed in paragraph 41 be communicated to the group engagement team when the work on the financial information of the component is completed.*