

Audit & Assurance Alert

CAS

AUGUST 2014

CAS 600 — Challenges in Complying with the Requirements in Group Audits

This Audit & Assurance Alert is being issued to raise awareness about challenging aspects of group audits and implementation issues noted in practice with CAS 600, *Special Considerations — Audits of Group Financial Statements (including the work of component auditors)*. The Alert is not intended to provide complete information relating to group audits. CAS 600 and other CASs contain additional requirements auditors must comply with when performing a group audit. Auditors may also refer to the *Implementation Tool for Auditors: Group Auditors' Involvement with Component Auditors: What, When and How?* and other relevant publications referred to in this Alert. Auditors may also refer to the CPA Canada Audit & Assurance Alert: *CAS 600—Challenges in Complying with the Requirements in Group Audits Involving Components Located in Emerging Markets*.

How do I use this Alert?

This Alert focuses on two specific aspects of a group audit, with a focus on the “WHAT,” and “HOW.” The “WHAT” identifies certain requirements with which the auditor is required to comply. The “HOW” provides some practical considerations and potential actions when addressing the requirements. It does not necessarily include all actions that may be needed, and some actions may not be relevant, to address the particular circumstances of the audit.

Practitioners working on group audits involving components located in emerging markets, may consider referring to the CPA Canada Audit & Assurance Alert: *CAS 600—Challenges in Complying with the Requirements in Group Audits Involving Components Located in Emerging Markets*.

Overall Audit Strategy

What

Determining the type of work to be performed on components

Relevant requirements: Paragraphs 26-29 of CAS 600

How

Determining the type of audit work to be performed at each component is a critical element of a group audit. This determination is important in addressing the risk that the auditor will not obtain sufficient appropriate audit evidence to support the group audit opinion. The group auditor considers whether sufficient appropriate audit evidence on which to base the group audit opinion has been (will be) obtained from the work performed on the financial information of significant components, group-wide controls and the consolidation process, and analytical procedures performed at the group level. If the group auditor concludes that sufficient appropriate audit evidence was not (will not be) obtained, the group engagement team must select components that are not significant and perform, or request a component auditor to perform, one or more audit responses as specified in paragraph 29 of CAS 600.

Determining financially significant components

There is no simple formula for determining which components should be audited because they are financially significant. Paragraph A5 of CAS 600 provides some guidance:

As the individual financial significance of a component increases, the risks of material misstatement of the group financial statements 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 involve the exercise of professional judgment. 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.

Determining those components that are significant because they are likely to include significant risks of material misstatement

The group auditor may also identify a component as likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances (that is, risks that require special audit consideration). The following areas may be relevant when considering whether a component may include significant risks of material misstatement of the group financial statements:

- Previous misstatements at the component.
- Presence of significant risks identified when obtaining an understanding of the group, its components and their environment.
- Significant intercompany transactions.
- Contingencies, such as lawsuits.

- Other highly subjective areas of the audit (for example, accounting estimates where there is a high degree of estimation uncertainty).
- Significant non-routine transactions (unusual, due to either size or nature, and that therefore occur infrequently) or judgmental matters.

This is not a complete list of indicators of components that are significant based on risk and the auditor uses judgment in determining whether the presence of one or more of these indicators results in the identification of a significant component.

Determining the nature and extent of audit work on non-significant components

Determining whether sufficient appropriate audit evidence on which to base the group audit opinion has been obtained is a matter of professional judgment. The group auditor is required to do analytical procedures on non-significant components, as stated in paragraph 28 of CAS 600. 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 may corroborate the group engagement team's conclusions that there are no significant risks of material misstatement at non-significant components.

A critical question for the group auditor is whether 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.
- c) The analytical procedures performed at group level.

When the group auditor does not consider that sufficient appropriate audit evidence will be obtained from the audit work performed on significant components, the auditor must comply with the requirements in paragraph 29 of CAS 600. The group engagement team's decision as to how many non-significant components to select, which components to select, and the type of work to be performed on the financial information of the individual components selected requires professional judgment.

Paragraph A51 of CAS 600 states that these decisions 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 the internal audit function 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.

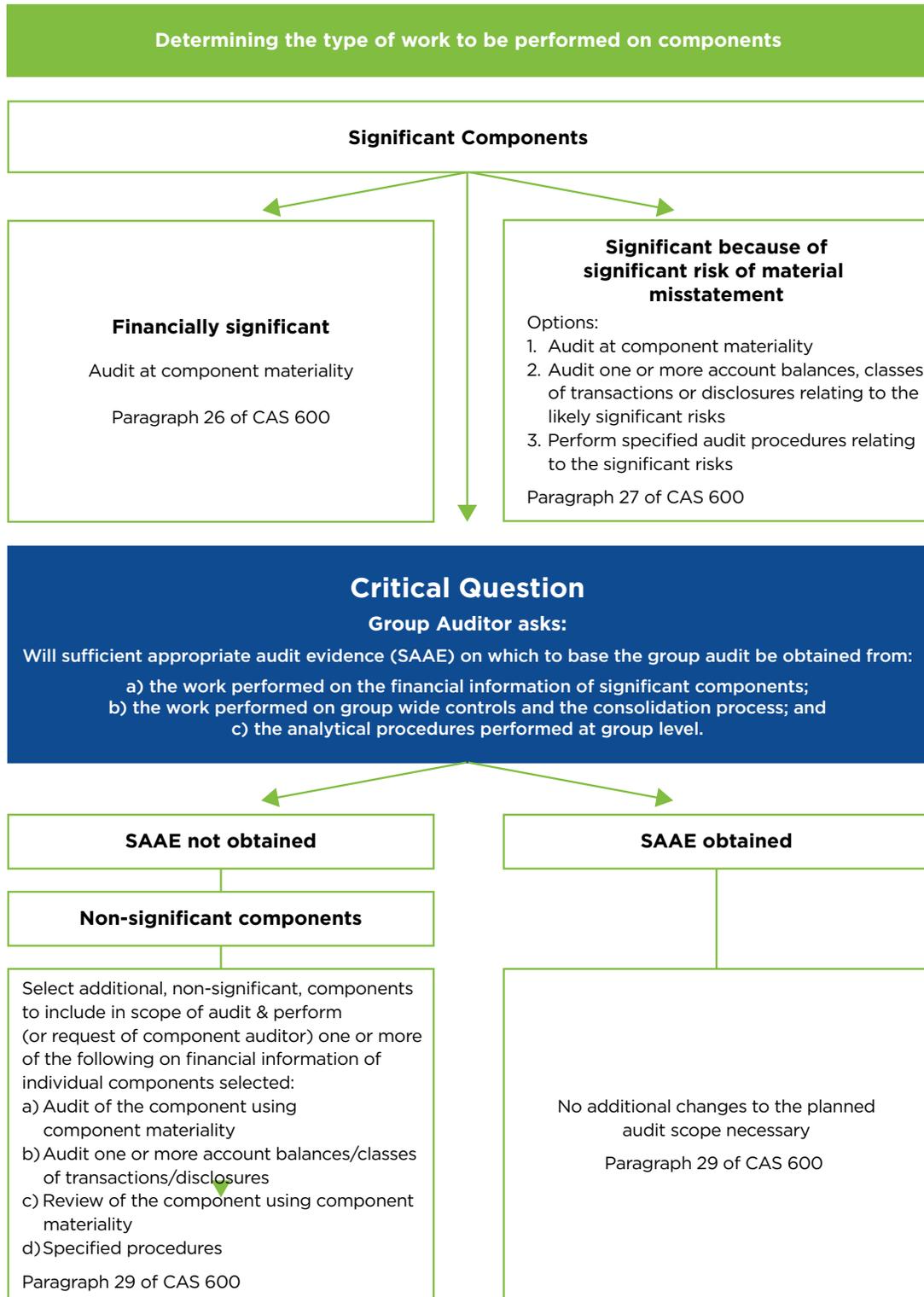
When applying the requirements of paragraph 29 of CAS 600, the group auditor is required to vary the selection of non-significant components over a period of time. This is because including an element of unpredictability in selecting non-significant components may increase the likelihood of identifying material misstatement of the components' financial information. The selection of components is often varied on a cyclical basis.

Group auditors are reminded of the requirement in paragraph 50 of CAS 600 to include in their audit documentation 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.

Summary of requirements

The following diagram provides an illustration of the audit requirements in paragraphs 26, 27, and 29 of CAS 600.



Materiality

What

Determining component materiality

Relevant requirements: Paragraphs 21-23 of CAS 600

How

Component materiality is determined by the group auditors and used when establishing the overall audit strategy for a component. Component materiality is determined for those components whose financial information will be audited or reviewed as part of the group audit. The component auditor uses component materiality to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate.

To reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole, component materiality must be lower than materiality for the group financial statements as a whole. Component materiality may be higher than materiality levels which would be determined by component auditors for the purposes of auditing an individual component's financial statements.

Different component materiality may be determined for different components. Component materiality need not be an arithmetical portion of the materiality for the group financial statements as a whole and, consequently, the aggregate of component materiality for the different components may exceed the materiality for the group financial statements as a whole. The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements.

What additional resources are available to help me?

Publications

Visit the CPA Canada website, where you will find additional resources:

1. [Audit & Assurance Alert: CAS 600: Challenges in Complying with the Requirements in Group Audits Involving Components Located in Emerging Markets](#)
2. [Implementation Tool for Auditors: Group Auditors' Involvement with Component Auditors: What, When and How?](#)
3. [FAQ for Auditors: Are You Sure You Don't Have to Apply CAS 600?](#)
4. [Audit Client Briefing: How Can Group Management Promote Effective Group Audits?](#)

Training Courses

CPA Canada's Practitioner's Pulse Webinar: Key Developments Affecting Your Practice; September 10, 2014, covering group audit matters.

Comments on this Audit & Assurance Alert, or suggestions for future Audit & Assurance Alerts should be sent to:

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