

1 New FRC Guidance for group audits (Lecture A672 – 17.11 minutes)

1.1 Overview

In 2018 the Financial Reporting Council (FRC) issued Staff Guidance Note (SGN) 02/2018 Group audits: *Determining whether components are significant and/or material, and what that means for key audit partners and engagement quality control reviewers*.

The title seems to imply that the guidance only related to Public Interest Entity (PIE) audits and/or where an Engagement Quality Control Review (EQCR) is required. However, much of the guidance is useful for other group audits and the FRC appear to expecting a wider application of some of the guidance, in any event.

1.2 ISA 600 – requirement to be involved in component audits

International Standard on Auditing (ISA) (UK) 600 (Revised June 2016) *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)*, contains a requirement for the Group Engagement Team (GET) to evaluate and review the work performed by component auditors where that work is used for the purpose of the group audit.

This is contained in para 42D-1, which is a UK plus requirement:

2D-1. The group engagement team shall:

- (a) evaluate **and review** the work performed by the component auditor for the purpose of the group audit; or
- (b) where the group engagement team is unable to request or secure the agreement required by paragraph 19D-1, take appropriate measures (including carrying out additional work, either directly or by outsourcing such tasks, in the relevant component) and inform the competent authority.

The nature and extent of the review of the component auditor’s work is not specified in ISA (UK) 600, but the new guidance from the FRC says:

- Where a component is financially significant, the GET is more likely to determine it necessary to review relatively more of the component auditor’s working papers.
- Where a component is significant due to certain account balances, classes of transactions or disclosures relating to significant risks of material misstatement of the group financial statements, the GET would likely focus their review on audit documentation for these areas.

- Where a component is **material** (which is a lower threshold than significant), the GET would likely limit their review to audit documentation that is relevant to the significant risks of material misstatement of the group financial statements.

Note: The auditor is required to determine which components are material to the group. This is in addition to identifying components that are individually financially significant and those that contain significant risk areas. Firms need to ensure that their processes for scoping the group audit include this consideration.

The extent of the review itself will always be determined by professional judgment, taking into account audit risk at group level.

1.3 Practical problems

It is clear that the group auditor will often need to review the audit work of component auditors but there can be practical problems, in addition, to determining the extent of the review.

Q. Are group auditors required to actually visit the component auditors?

A. No. However, it is not always possible to remotely access the audit file. Shared electronic audit platforms can be very useful for sharing the documentation but this is usually only possible when the component auditor is a network firm.

Screen sharing technologies can be used to, as can good old fashioned email, although there can be data protection and custody issues with the later

Sometimes the component auditor will refuse remote access in this way and a visit will be necessary. Also, group auditors might choose to visit, to gain a better understanding of the component, its auditor and the work done.

Sometimes visiting can be very inconvenient, especially if the component is based at the other end of a long-haul flight. Also, don't forget that you might need a visa to travel to certain jurisdictions, so some advance planning could be needed.

Q. What if the component auditor documents their work in a foreign language?

A. There are many different ways to deal with this:

- the group auditor might have a member of staff with that language skill who can understand the file;
- ideally they would be an auditor with the appropriate audit skills too, but non-audit members of staff could act as a translator;
- the firm could engage the services of a third party independent translator; or
- the firm could engage a local audit firm to assist them or conduct the review on their behalf.

Q. What happens if the group auditor cannot rely (or chooses not to rely) on the component auditor's work?

A. The group auditor could obtain the audit evidence through conducting their own programme of audit work, and could possibly use a local audit firm to do the work on their behalf.

1.4 Documentation of the review

Paragraph 50D-1 of ISA (UK) 600 requires that the GET document their review of the relevant parts of the component auditor's documentation. This will include:

- what working papers were reviewed and when they were reviewed, with some detail of what was in those working papers, and not just a list of them;
- details of where the work of the component auditors was challenged and how the GET were satisfied that the component auditor had addressed these challenges;
- results of the work, including matters arising such as exceptions/misstatements identified by the component auditor and how they were addressed;
- details of any discussions with component management; and
- the GET's conclusions as to the adequacy of the work, and whether it provides sufficient appropriate audit evidence (in conjunction with work on other components and work performed at group level) to support their audit opinion on the group financial statements.

1.5 Application date

There is no application date for the new FRC guidance. It should be complied with as soon as possible.