Group Audits – A Year Later

Almost a year has passed since the clarity audit standards became effective. The AICPA Auditing Standards Board (ASB) completed the clarity project in effort to make U.S. generally accepted auditing standards (GAAS) easier to read, understand, and apply as well as to begin converging U.S. GAAS with International Standards on Auditing (ISA). As part of the clarity standards project for U.S. GAAS, the AICPA indicated that AU-C section 600 Audits of Group Financial Statements was one of the most significant changes as result of the clarity project. A significant outcome of these standards was the group audit requirements.

Listed below are common examples of what triggers “group audits”:

- Subsidiaries or related parties are consolidated in the reporting entity
- Multiple business divisions or activities, regions or locations that maintain separate accounting records and are ultimately combined in the reporting entity
- Investments in joint ventures accounted for under the equity method (or in some cases the cost method) of accounting

After determining that your audit qualifies as group audit, what is next? The clarity standards require certain procedures and communications take place. In addition to these requirements, DHG’s best practices are incorporated below:

1. **Identify the components within the group and evaluate the significant components that could affect the group financial statements.**

   The auditor is required to gain an understanding of the group, the component and their control environments. If the component is audited, the group auditor will need to be in contact with the component auditor to determine the overall audit strategy and risks of material misstatement.

   Auditors are to assess risk, develop appropriate audit responses, and apply materiality levels at each significant component level. In planning, auditors must assess these components and determine what work will be performed in order for the audit to run efficiently and effectively. The standards allow auditors to exercise judgment in determining how the components are identified – a common approach is based on the financial reporting structure of the group. Significant components can be identified based on financial benchmarks, professional judgment and/or significant risks of material misstatement due to the specific nature or circumstance of the component. Components that are determined not significant require significantly less audit work and documentation.

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2. Determine whether to make reference or assume responsibility for the work of the component auditor.

To reference or assume responsibility will dictate the work to be performed by the group auditor and identify the nature, timing, and extent of involvement in the component auditor’s work.

When making reference to the component audit in the group audit report, the audited financial statements of the component must be included with the group financial statements. The auditor has a responsibility to obtain communications on significant findings, materiality levels used, and read the audited financial statements. Since the clarified auditing standards became effective, the ASB has amended paragraph 25a in January 2013 to permit making reference to the audit of a component in the group audit report when the component’s financial statements are prepared using a different financial reporting framework than that used for the group financial statements, if certain conditions are met. The group auditor must disclose the accepted responsibility for evaluating the appropriateness of the adjustments to convert the component’s financial statements to the financial reporting framework used by the group.

When assuming responsibility for the work of the component auditor, the group auditor should be involved in the risk assessment process of the component audit team. This communication ensures that both audit teams are working together to address significant risks at the group level. The group auditor may request the component auditor’s to perform specified procedures during their audit or perform the procedures themselves. The group auditor may also consider it necessary to review the work performed by the component auditor for further evaluation.

3. Communication between the group auditor and component auditor is important evidence and is best presented early in the component’s audit process.

Under the standards, the group auditor is responsible for the direction, supervision, and performance of the group audit as well as communicating certain requirements that are relevant to the group audit. The timing of this communication is key and is best presented before or during the planning stages of the component’s audit. Communications between the group and component auditors typically includes direction regarding significant risks, materiality levels to be used for testing, identification and disclosures of related parties and fraud considerations. In addition, documented communications between the auditors will often identify the group auditor’s involvement in the component’s audit, request a summary of important audit results at the conclusion of the component audit, and specify subsequent event procedures timeline and timing of completion. These communications become the basis for the group auditor to evaluate the sufficiency of the audit evidence presented and determine whether additional procedures are required to support the group audit opinion.

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The new guidance indeed makes more CPAs collaborate for better auditing results. For more information contact your Dixon Hughes Goodman Advisor or Jennifer Tilley at 703.970.0440 or jennifer.tilley@dhgllp.com.

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