

AU-C Section 600

Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

Source: SAS No. 122; SAS No. 127; SAS No. 128.

See section 9600 for interpretations of this section.

Effective for audits of group financial statements for periods ending on or after December 15, 2012.

NOTE

In October 2015, the Auditing Standards Board issued SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (sec. 940), which contains amendments to this section.

The amendments are effective for integrated audits for periods ending on or after December 15, 2016, and can be viewed in the appendix of section 940 until the effective date, when they will be applied to this section.

Introduction

Scope of This Section

.01 Generally accepted auditing standards (GAAS) apply to group audits. This section addresses special considerations that apply to group audits, in particular those that involve component auditors.

.02 An auditor may find this section, adapted as necessary in the circumstances, useful when that auditor involves other auditors in the audit of financial statements that are not group financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect physical fixed assets at a remote location.

.03 A component auditor may be required by law or regulation or may have been engaged by component management for another reason to express an audit opinion on the financial statements of a component. The requirements of this section apply, nonetheless, regardless of whether the group engagement partner decides to make reference to the component auditor in the auditor's report on the group financial statements or to assume responsibility for the work of component auditors.

.04 Governmental entities frequently prepare group financial statements. The AICPA Audit and Accounting Guide *State and Local Governments* provides guidance to assist auditors in auditing and reporting on those financial statements in accordance with GAAS, including the requirements of this section.

.05 In accordance with section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*, the

group engagement partner is required to be satisfied that those performing the group audit engagement, including component auditors, collectively possess the appropriate competence and capabilities.¹ The group engagement partner also is responsible for the direction, supervision, and performance of the group audit engagement. In this section, requirements to be undertaken by the group engagement partner are addressed to the group engagement partner. When the group engagement team may assist the group engagement partner in fulfilling a requirement, the requirement is addressed to the group engagement team. When it may be appropriate in the circumstances for the firm to fulfill a requirement, the requirement is addressed to the auditor of the group financial statements.

.06 The requirements of section 220 apply regardless of whether the group engagement team or a component auditor performs the work on the financial information of a component. This section assists the group engagement partner to meet the requirements of section 220 when component auditors perform work on the financial information of components.

.07 Audit risk is a function of the risk of material misstatement of the financial statements and the risk that the auditor will not detect such misstatements.² In a group audit, detection risk includes the risk that a component auditor may not detect a misstatement in the financial information of a component that could cause a material misstatement of the group financial statements and the risk that the group engagement team may not detect this misstatement. This section 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 statements.

.08 The group engagement partner is responsible for deciding, individually for each component, to either

- assume responsibility for, and thus be required to be involved in, the work of a component auditor, insofar as that work relates to the expression of an opinion on the group financial statements, or
- not assume responsibility for, and accordingly make reference to, the audit of a component auditor in the auditor's report on the group financial statements.

The requirements in paragraphs .51–.65 are applicable only when the auditor of the group financial statements is assuming responsibility for the work of component auditors. All other requirements in this section apply to all audits of group financial statements.

Effective Date

.09 This section is effective for audits of group financial statements for periods ending on or after December 15, 2012.

Objectives

.10 The objectives of the auditor are to determine whether to act as the auditor of the group financial statements and, if so, to

¹ Paragraph .16 of section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*.

² Paragraph .A36 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

- a. determine whether to make reference to the audit of a component auditor in the auditor's report on the group financial statements;
- b. communicate clearly with component auditors; and
- c. obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion about whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Definitions

.11 For purposes of GAAS, the following terms have the meanings attributed as follows:

Component. An entity or business activity for which group or component management prepares financial information that is required by the applicable financial reporting framework to be included in the group financial statements. (Ref: par. .A1–.A5)

Component auditor. An auditor who performs work on the financial information of a component that will be used as audit evidence for the group audit. A component auditor may be part of the group engagement partner's firm, a network firm of the group engagement partner's firm, or another firm. (Ref: par. .A9–.A11)

Component management. Management responsible for preparing the financial information of a component.

Component materiality. The materiality for a component determined by the group engagement team for the purposes of the group audit.

Group. All the components whose financial information is included in the group financial statements. A group always has more than one component.

Group audit. The audit of group financial statements.

Group audit opinion. The audit opinion on the group financial statements.

Group engagement partner. The partner or other person in the firm³ who is responsible for the group audit engagement and its performance and for the auditor's report on the group financial statements that is issued on behalf of the firm. When 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 section does not, however, address the relationship between joint auditors or the work that one joint auditor performs in relation to the work of the other joint auditor.

Group engagement team. 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 statements.

³ *Group engagement partner and firm* refer to their governmental equivalents when relevant.

Group financial statements. Financial statements that include the financial information of more than one component. The term *group financial statements* also refers to combined financial statements aggregating the financial information prepared by components that are under common control.

Group management. Management responsible for the preparation and fair presentation of the group financial statements.

Group-wide controls. Controls designed, implemented, and maintained by group management over group financial reporting.

Significant component. 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 of material misstatement of the group financial statements. (Ref: par. .A6–.A8)

.12 Reference to *the applicable financial reporting framework* means the financial reporting framework that applies to the group financial statements. Reference to *the consolidation process* includes the following:

- a. The recognition, measurement, presentation, and disclosure of the financial information of the components in the group financial statements by way of inclusion, consolidation, proportionate consolidation, or the equity or cost methods of accounting (Ref: par. .A12)
- b. The aggregation in combined financial statements of the financial information of components that are under common control

Requirements

Responsibility

.13 In accordance with section 220, the group engagement partner is responsible for (1) the direction, supervision, and performance of the group audit engagement in compliance with professional standards, applicable regulatory and legal requirements, and the firm's policies and procedures; and (2) determining whether the auditor's report that is issued is appropriate in the circumstances.⁴ (Ref: par. .A13–.A14)

Acceptance and Continuance

.14 The group engagement partner should determine whether sufficient appropriate audit evidence can reasonably be expected to be obtained regarding 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 should obtain an understanding of the group, its components, and their environments that is sufficient to identify components that are likely to be significant components. (Ref: par. .A15–.A17)

.15 The group engagement partner should evaluate whether the group engagement team will be able to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors (that is, through assuming responsibility for the work of component auditors or through making reference to the audit of a component auditor in

⁴ Paragraph .17 of section 220.

the auditor's report), to act as the auditor of the group financial statements and report as such on the group financial statements. (Ref: par. .A18–.A21)

.16 In some circumstances, the group engagement partner may conclude that it will not be possible, due to restrictions imposed by group management, for the group engagement team to obtain sufficient appropriate audit evidence through the group engagement team's work or use of the work of component auditors, and the possible effect of this inability, will result in a disclaimer of opinion on the group financial statements.⁵ In such circumstances, the auditor of the group financial statements should

- in the case of a new engagement, not accept the engagement, or, in the case of a continuing engagement, withdraw from the engagement when withdrawal is possible under applicable law or regulation, or
- when the entity is required by law or regulation to have an audit, having performed the audit of the group financial statements to the extent possible, disclaim an opinion on the group financial statements. (Ref: par. .A22–.A27)

Terms of Engagement

.17 The auditor of the group financial statements is required, in accordance with section 210, *Terms of Engagement*, to agree upon the terms of the group audit engagement.⁶ (Ref: par. .A28–.A29)

Overall Audit Strategy and Audit Plan

.18 The group engagement team should establish an overall group audit strategy and should develop a group audit plan. In developing the group audit plan, the group engagement team should assess the extent to which the group engagement team will use the work of component auditors and whether the auditor's report on the group financial statements will make reference to the audit of a component auditor, as discussed in paragraphs .24–.30.

.19 The group engagement partner should review and approve the overall group audit strategy and group audit plan. (Ref: par. .A30)

Understanding the Group, Its Components, and Their Environments

.20 The auditor is required to identify and assess the risks of material misstatement through obtaining an understanding of the entity and its environment.⁷ The group engagement team should

- a. enhance its understanding of the group, its components, and their environments, including group-wide controls, obtained during the acceptance or continuance stage.
- b. obtain an understanding of the consolidation process, including the instructions issued by group management to components. (Ref: par. .A31–.A37)

.21 The group engagement team should obtain an understanding that is sufficient to

⁵ Paragraphs .11–.14 of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

⁶ Paragraph .09 of section 210, *Terms of Engagement*.

⁷ See section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

- a. confirm or revise its initial identification of components that are likely to be significant.
- b. assess the risks of material misstatement of the group financial statements, whether due to fraud or error.⁸ (Ref: par. .A38–.A39)

Understanding a Component Auditor

.22 Regardless of whether reference will be made in the auditor's report on the group financial statements to the audit of a component auditor, the group engagement team should obtain an understanding of the following: (Ref: par. .A40–.A44)

- a. Whether a component auditor understands and will comply with the ethical requirements that are relevant to the group audit and, in particular, is independent (Ref: par. .A46)
- b. A component auditor's professional competence (Ref: par. .A47–.A48)
- c. The extent, if any, to which the group engagement team will be able to be involved in the work of the component auditor
- d. Whether the group engagement team will be able to obtain information affecting the consolidation process from a component auditor
- e. Whether a component auditor operates in a regulatory environment that actively oversees auditors (Ref: par. .A45)

.23 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 .22a–b, the group engagement team should obtain sufficient appropriate audit evidence relating to the financial information of the component without making reference to the audit of that component auditor in the auditor's report on the group financial statements or otherwise using the work of that component auditor. (Ref: par. .A49–.A51)

Determining Whether to Make Reference to a Component Auditor in the Auditor's Report on the Group Financial Statements

.24 Having gained an understanding of each component auditor, the group engagement partner should decide whether to make reference to a component auditor in the auditor's report on the group financial statements. (Ref: par. .A52)

.25 Reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

- a. the group engagement partner has determined that the component auditor has performed an audit of the financial statements of the component in accordance with the relevant requirements of GAAS (Ref: par. .A53), and
- b. the component auditor has issued an auditor's report that is not restricted as to use.⁹

⁸ See section 315.

⁹ See section 905, *Alert That Restricts the Use of the Auditor's Written Communication*. [Footnote revised, August 2012, to reflect conforming changes necessary due to the issuance of SAS No. 125.]

[As amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.26 If the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements, reference to the audit of a component auditor in the auditor's report on the group financial statements should not be made unless

- a. the measurement, recognition, presentation, and disclosure criteria that are applicable to all material items in the component's financial statements under the financial reporting framework used by the component are similar to the criteria that are applicable to all material items in the group's financial statements under the financial reporting framework used by the group, and
- b. the group engagement team has obtained sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for, and, thus, be involved in, the work of the component auditor. (Ref: par. .A54–.A57)

[Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.27 When the group engagement partner decides to make reference in the auditor's report on the group financial statements to the audit of a component auditor, the group engagement team should obtain sufficient appropriate audit evidence with regard to such components by performing the following procedures:

- a. The procedures required by this section, except for those required by paragraphs .51–.65
- b. Reading the component's financial statements and the component auditor's report thereon to identify significant findings and issues and, when considered necessary, communicating with the component auditor in this regard

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Making Reference in the Auditor's Report

.28 When the group engagement partner decides to make reference to the audit of a component auditor in the auditor's report on the group financial statements, the report on the group financial statements should clearly indicate

- a. that the component was not audited by the auditor of the group financial statements but was audited by the component auditor.
- b. the magnitude of the portion of the financial statements audited by the component auditor.
- c. when the component's financial statements are prepared using a different financial reporting framework from that used for the group financial statements
 - i. the financial reporting framework used by the component and
 - ii. that the auditor of the group financial statements is taking responsibility for evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group.

- d. when
- i. the component auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, and
 - ii. the group engagement partner has determined that the component auditor performed additional audit procedures in order to meet the relevant requirements of GAAS
 - (1) the set of auditing standards used by the component auditor and
 - (2) that additional audit procedures were performed by the component auditor to meet the relevant requirements of GAAS. (Ref: par. .A58–.A60)

[Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.29 If the group engagement partner decides to name a component auditor in the auditor's report on the group financial statements

- a. the component auditor's express permission should be obtained.
- b. the component auditor's report should be presented together with that of the auditor's report on the group financial statements.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.30 If the opinion of a component auditor is modified or that report includes an emphasis-of-matter or other-matter paragraph, the auditor of the group financial statements should determine the effect that this may have on the auditor's report on the group financial statements. When deemed appropriate, the auditor of the group financial statements should modify the opinion on the group financial statements or include an emphasis-of-matter paragraph or an other-matter paragraph in the auditor's report on the group financial statements. (Ref: par. .A61) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.31 If the group engagement partner decides to assume responsibility for work of a component auditor, no reference should be made to the component auditor in the auditor's report on the group financial statements. (Ref: par. .A62) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Materiality

.32 The group engagement team should determine the following: (Ref: par. .A63)

- a. Materiality, including performance materiality, for the group financial statements as a whole when establishing the overall group audit strategy.¹⁰
- b. Whether, in the specific circumstances of the group, particular classes of transactions, account balances, or disclosures in the group financial statements exist for which misstatements of lesser amounts than materiality for the group financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the group financial

¹⁰ See section 320, *Materiality in Planning and Performing an Audit*.

statements. In such circumstances, the group engagement team should determine materiality to be applied to those particular classes of transactions, account balances, or disclosures.

- c. Component materiality for those components on which the group engagement team will perform, or for which the auditor of the group financial statements will assume responsibility for the work of a component auditor who performs, an audit or a review. Component materiality should be determined taking into account all components, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of a component auditor. To reduce the risk that the aggregate of uncorrected and undetected misstatements in the group financial statements exceeds the materiality for the group financial statements as a whole, component materiality should be lower than the materiality for the group financial statements as a whole, and component performance materiality should be lower than performance materiality for the group financial statements as a whole. (Ref: par. .A64–.A66)
- d. The threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements. (Ref: par. .A67)

See paragraph .51 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Responding to Assessed Risks

.33 The auditor is required to design and implement appropriate responses to address the assessed risks of material misstatement of the financial statements.¹¹ If the nature, timing, and extent of the work to be performed on the consolidation process or the financial information of the components is 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 should test, or have a component auditor test on the group engagement team's behalf, the operating effectiveness of those controls. See paragraphs .52–.58 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. (Ref: par. .A68) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Consolidation Process

.34 In accordance with paragraph .20, 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 .33, 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 substantive procedures

¹¹ See section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

alone cannot provide sufficient appropriate audit evidence at the assertion level. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.35 The group engagement team should design and perform further audit procedures on the consolidation process to respond to the assessed risks of material misstatement of the group financial statements arising from the consolidation process. This should include evaluating whether all components have been included in the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.36 The group engagement team should evaluate the appropriateness, completeness, and accuracy of consolidation adjustments and reclassifications and should evaluate whether any fraud risk factors or indicators of possible management bias exist. (Ref: par. .A69) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.37 If the financial information of a component has not been prepared in accordance with the same accounting policies applied to the group financial statements, the group engagement team should evaluate whether the financial information of that component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. (Ref: par. .A57) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.38 The group engagement team should determine whether the financial information identified in a component auditor's communication (see paragraph .42b) is the financial information that is incorporated in the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.39 If the group financial statements include the financial statements of a component with a financial reporting period-end that differs from that of the group, the group engagement team should evaluate whether appropriate adjustments have been made to those financial statements in accordance with the applicable financial reporting framework. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events

.40 When the group engagement team or component auditors perform audits on the financial information of components, the group engagement team or the component auditors should 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 statements and that may require adjustment to, or disclosure in, the group financial statements. See paragraph .59 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. (Ref: par. .A70) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor

.41 The group engagement team should communicate its requirements to a component auditor on a timely basis. This communication should 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, confirm that the component auditor will cooperate with the group engagement team.
- b. The ethical requirements that are relevant to the group audit and, in particular, the independence requirements.
 - c. 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 should request the component auditor to communicate on a timely basis related parties not previously identified by group management or the group engagement team. The group engagement team should identify such additional related parties to other component auditors.
 - d. Identified significant risks of material misstatement of the group financial statements, due to fraud or error, that are relevant to the work of the component auditor.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.42 The group engagement team should request a component auditor to communicate matters relevant to the group engagement team's conclusion, with regard to the group audit. Such communication should include the following:

- a. Whether the component auditor has complied with ethical requirements relevant to the group audit, including independence and professional competence
- b. Identification of the financial information of the component on which the component auditor is reporting
- c. The component auditor's overall findings, conclusions, or opinion

See paragraphs .60–.61 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Evaluating a Component Auditor's Communication and Adequacy of Their Work

.43 The group engagement team should evaluate a component auditor's communication (see paragraph .42). The group engagement team should discuss significant findings and issues arising from that evaluation with the component auditor, component management, or group management, as appropriate. See paragraphs .60–.63 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Sufficiency and Appropriateness of Audit Evidence

.44 The auditor is required to obtain sufficient appropriate audit evidence on which to base the audit opinion.¹² The group engagement team should evaluate whether sufficient appropriate audit evidence on which to base the group audit opinion has been obtained from the audit procedures performed on the consolidation process and the work performed by the group engagement team

¹² Paragraph .19 of section 200.

and the component auditors on the financial information of the components. (Ref: par. .A71) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.45 The group engagement partner should 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 in which there has been an inability to obtain sufficient appropriate audit evidence. (Ref: par. .A72) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management and Those Charged With Governance

.46 The group engagement team should communicate to group management and those charged with governance of the group material weaknesses and significant deficiencies in internal control that are relevant to the group (either identified by the group engagement team or brought to its attention by a component auditor during the audit), in accordance with section 265, *Communicating Internal Control Related Matters Identified in an Audit*. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.47 If fraud has been identified by the group engagement team or brought to its attention by a component auditor or information indicates that a fraud may exist, the group engagement team should 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: par. .A73) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.48 When a component auditor has been engaged to express an audit opinion on the financial statements of a component, the group engagement team should 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 statements of the component, but of which component management may be unaware. If group management refuses to communicate the matter to component management, the group engagement team should 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, should consider whether to advise the component auditor not to issue the auditor's report on the financial statements of the component until the matter is resolved and whether to withdraw from the engagement. (Ref: par. .A74) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Those Charged With Governance of the Group

.49 The group engagement team should communicate the following matters with those charged with governance of the group, in addition to those required by section 260, *The Auditor's Communication With Those Charged With Governance*, and other AU-C sections: (Ref: par. .A75)

- a. An overview of the type of work to be performed on the financial information of the components, including the basis for the decision

to make reference to the audit of a component auditor in the auditor's report on the group financial statements

- 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 in which 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, when 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 in which a material misstatement of the group financial statements has or may have resulted from fraud

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Documentation

.50 The group engagement team should include in the audit documentation the following:¹³

- a. An analysis of components indicating those that are significant and the type of work performed on the financial information of the components
- b. Those components for which reference to the reports of component auditors is made in the auditor's report on the group financial statements
- c. Written communications between the group engagement team and the component auditors about the group engagement team's requirements
- d. For those components for which reference is made in the auditor's report on the group financial statements to the audit of a component auditor
 - i. the financial statements of the component and the report of the component auditor thereon
 - ii. when the component auditor's report on the component's financial statements does not state that the audit of the component's financial statements was performed in accordance with GAAS or the standards promulgated by the PCAOB, the basis for the group engagement partner's determination that the audit performed by the component auditor met the relevant requirements of GAAS

See paragraph .65 for additional requirements that apply when the auditor of the group financial statements is assuming responsibility for the work of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

¹³ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

Additional Requirements Applicable When Assuming Responsibility for the Work of a Component Auditor

Materiality (See paragraph .32)

.51 In the case of an audit of the financial information of a component in which the auditor of the group financial statements is assuming responsibility for the component auditor's work, the group engagement team should evaluate the appropriateness of performance materiality at the component level. (Ref: par. .A76–.A77) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Determining the Type of Work to Be Performed on the Financial Information of Components (See paragraph .33)

.52 For components for which the auditor of the group financial statements is assuming responsibility for the work of component auditors, the group engagement team should determine the type of work to be performed by the group engagement team or by component auditors on its behalf on the financial information of the components (see paragraphs .53–.56). The group engagement team also should determine the nature, timing, and extent of its involvement in the work of component auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Significant Components

.53 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, should perform an audit of the financial information of the component, adapted as necessary to meet the needs of the group engagement team, using component materiality. (Ref: par. .A78) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.54 For a component that is significant not due to its individual financial significance but because it is likely to include significant risks of material misstatement of the group financial statements due to its specific nature or circumstances, the group engagement team, or a component auditor on its behalf, should perform one or more of the following: (Ref: par. .A79)

- a. An audit, adapted as necessary to meet the needs of the group engagement team, of the financial information of the component, using component materiality
- b. An audit, adapted as necessary to meet the needs of the group engagement team, of one or more account balances, classes of transactions, or disclosures relating to the likely significant risks of material misstatement of the group financial statements (Ref: par. .A80)
- c. Specified audit procedures relating to the likely significant risks of material misstatement of the group financial statements (Ref: par. .A81)

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Components That Are Not Significant Components

.55 For components that are not significant components, the group engagement team should perform analytical procedures at the group level. (Ref: par. .A82) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.56 In some circumstances, the group engagement team may determine that sufficient appropriate audit evidence on which to base the group audit opinion will not be obtained from the following:

- 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

In such circumstances, the group engagement team should select additional components that are not significant components and should perform or request a component auditor to perform one or more of the following on the financial information of the individual components selected: (Ref: par. .A83–.A86)

- An audit, adapted as necessary to meet the needs of the group engagement team, of the financial information of the component, using component materiality
- An audit, adapted as necessary to meet the needs of the group engagement team, of one or more account balances, classes of transactions, or disclosures
- A review of the financial information of the component, adapted as necessary to meet the needs of the group engagement team, using component materiality
- Specified audit procedures

The group engagement team should vary the selection of such individual components over a period of time. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Involvement in the Work Performed by Component Auditors **(Ref: par. .A87–.A88)**

Significant Components—Risk Assessment

.57 When a component auditor performs an audit or other specified audit procedures of the financial information of a significant component for which the auditor of the group financial statements is assuming responsibility for the component auditor's work, the group engagement team should be involved in the risk assessment of the component to identify significant risks of material misstatement of the group financial statements. 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, should include the following:

- a. Discussing with the component auditor or component management the component's business activities of significance 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.
- c. Reviewing the component auditor's documentation of identified significant risks of material misstatement of the group financial statements. Such documentation may take the form of a memorandum that reflects the component auditor's conclusion with regard to the identified significant risks.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

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

.58 When significant risks of material misstatement of the group financial statements have been identified in a component for which the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the group engagement team should 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 statements. Based on its understanding of the component auditor, the group engagement team should determine whether it is necessary to be involved in the further audit procedures. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events (See paragraph .40)

.59 When component auditors perform work other than audits of the financial information of components at the request of the group engagement team, the group engagement team should request the component auditors to notify the group engagement team if they become aware of 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 statements that may require an adjustment to, or disclosure in, the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor (See paragraph .42)

.60 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the communication required in paragraph .41 should set out the work to be performed and the form and content of the component auditor's communication with the group engagement team. It also should include, 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 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 statements. (Ref: par. .A89–.A92) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.61 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, the communication requested from the component auditor, as required in paragraph .42, also should include the following:

- a. Whether the component auditor has complied with the group engagement team's requirements.
- b. Information on instances of noncompliance with laws or regulations at the component or group level that could give rise to a material misstatement of the group financial statements.
- c. Significant risks of material misstatement of the group financial statements, due to fraud or error, identified by the component auditor in the component and the component auditor's responses to such risks. The group engagement team should request the component auditor to communicate such significant risks on a timely basis.

- d. A list of corrected and 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).
- e. Indicators of possible management bias regarding accounting estimates and the application of accounting principles.
- f. Description of any identified material weaknesses and significant deficiencies in internal control at the component level.
- g. Other significant findings and issues 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 that resulted in a material misstatement of the financial information of the component.
- h. 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.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating a Component Auditor's Communication and Adequacy of Their Work (See paragraph .43)

.62 The group engagement team should determine, based on the evaluation required in paragraph .43, whether it is necessary to review other relevant parts of a component auditor's audit documentation. (Ref: par. .A93) [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.63 If the group engagement team concludes that the work of a component auditor is insufficient, the group engagement team should determine additional procedures to be performed and whether they are to be performed by the component auditor or by the group engagement team. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group (See paragraphs .46–.49)

.64 The group engagement team should determine which material weaknesses and significant deficiencies in internal control that component auditors have brought to the attention of the group engagement team should be communicated to group management and those charged with governance of the group. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Documentation (See paragraph .50)

.65 The group engagement team should include in the audit documentation the nature, timing, and extent of the group engagement team's involvement in the work performed by the component auditors on significant components, including, when applicable, the group engagement team's review of relevant parts of the component auditors' audit documentation and conclusions thereon. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Application and Other Explanatory Material

Definitions

Component (Ref: par. . 11)

.A1 The structure of a group affects how components are identified. For example, the group financial reporting system may be based on an organizational 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 organize 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 statements may be a function, process, product or service (or group of products or services), or geographical location.

.A2 An investment accounted for under the equity method constitutes a component for purposes of this section. Investments accounted for under the cost method may be analogous to a component for purposes of this section when the work and reports of other auditors constitute a major element of evidence for such investments.

.A3 Various levels of components may exist within the group financial reporting system, in which case it may be more appropriate to 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 also may prepare group financial statements that incorporate the financial information of the components it encompasses (that is, a subgroup). This section may, therefore, be applied by different group engagement partners and teams for different subgroups within a larger group.

Considerations Specific to Audits of Governmental Entities

.A5 In audits of state and local governments, a component may be a separate legal entity reported as a component unit or part of the governmental entity, such as a business activity, department, or program.

Significant Component (Ref: par. . 11)

.A6 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 to it involve the exercise of professional judgment. Depending on the nature and circumstances of the group, appropriate benchmarks might include group assets, liabilities, cash flows, revenues, expenditures, or net income. For example, the group engagement team may consider that components exceeding a specified percentage of the chosen benchmark are significant components.

.A7 The group engagement team also may 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 consideration¹⁴). 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.

Considerations Specific to Governmental Entities

.A8 In audits of governmental entities, appropriate quantitative benchmarks for identifying significant components might include net costs or total budget. Qualitative considerations in audits of governmental entities may involve matters of heightened public sensitivity, such as national security issues, donor funded projects, or reporting of tax revenue.

Component Auditor (Ref: par. .11)

.A9 For purposes of this section, auditors who do not meet the definition of a member of the group engagement team are considered to be component auditors. However, an auditor who performs work on a component when the group engagement team will not use that work to provide audit evidence for the group audit is not considered a component auditor.

.A10 When two or more component auditors exist, the provisions of this section are applicable to each component auditor.

.A11 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. When this is the case, such a member of the group engagement team also is a component auditor.

Consolidation Process (Ref: par. .12)

Considerations Specific to Governmental Entities

.A12 In audits of state and local governments, the applicable financial reporting framework may be based on multiple reporting units. Therefore, the consolidation process may involve the inclusion, but separate presentation, of the financial statements of each reporting unit in the governmental entity.

Responsibility (Ref: par. .13)

.A13 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. However, regardless of whether reference is made in the auditor's report on the group financial statements to the report of a component auditor, the auditor of the group financial statements is responsible for the group audit opinion.

Considerations Specific to Governmental Entities

.A14 When the auditor of the group financial statements is engaged to express opinions on both the group financial statements and the separate financial statements of the components presented in the group financial statements, the auditor's reporting responsibilities with respect to the separate financial statements are the same as the auditor's responsibilities with respect to the group financial statements.

¹⁴ Paragraphs .28–.30 of section 315.

Acceptance and Continuance

Obtaining an Understanding at the Acceptance or Continuance Stage ***(Ref: par. .14)***

.A15 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 the following:

- Information provided by group management
- Communication with group management
- When applicable, communication with the previous group engagement team, component management, or component auditors

.A16 The group engagement team's understanding may include matters such as the following:

- The group structure, including both the legal and organizational structure (that is, how the group financial reporting system is organized)
- 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 organizations, including shared service centers
- 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 engaging more than one auditor, if applicable
- 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)
 - will be able to perform necessary work on the financial information of the components

.A17 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, such as the following:

- Changes in the group structure (for example, acquisitions, disposals, reorganizations, or changes in how the group financial reporting system is organized)
- 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
- 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

Expectation to Obtain Sufficient Appropriate Audit Evidence (Ref: par. .15)

.A18 Relevant factors in determining whether to act as the auditor of the group financial statements include, among other things, the following:

- The individual financial significance of the components, as determined in accordance with the guidance in paragraph .A6, for which the auditor of the group financial statements will be assuming responsibility
- The extent to which significant risks of material misstatement of the group financial statements are included in the components for which the auditor of the group financial statements will be assuming responsibility
- The extent of the group engagement team's knowledge of the overall financial statements

.A19 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.
- b. use the work performed by component auditors on the financial information of other components to the extent necessary to obtain sufficient appropriate audit evidence.

.A20 When the auditor of the group financial statements is assuming responsibility for the work performed by a component auditor, the group engagement team is required by the provisions of this section to be involved in the work of the component auditor. Paragraph .27 describes the procedures to be followed to obtain sufficient appropriate audit evidence when the group engagement partner decides to make reference in the auditor's report on the group financial statements to the audit of a component auditor.

Considerations Specific to Governmental Entities

.A21 Additional factors in determining whether to act as the auditor of the group financial statements in audits of state and local governments include, the following:

- Engagement by the primary government as the auditor of the financial reporting entity
- Responsibility for auditing the primary government's general fund (or other primary operating fund)

Access to Information (Ref: par. .16)

.A22 The group engagement team's access to information may be restricted by group management, or it may be restricted by circumstances that cannot be overcome by group management (for example, laws relating to confidentiality and data privacy or denial by a component auditor of access to relevant audit documentation sought by the group engagement team).

.A23 When 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 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 complete set of financial statements of the component, including the auditor's report thereon, and has access to information kept by group management regarding that component, the group engagement team may conclude that this information constitutes sufficient appropriate audit evidence regarding that component. If the component is a significant component, however, and the auditor of the group financial statements is not making reference to the audit of a component auditor in the auditor's report on the group financial statements, then the group engagement team will not be able to comply with the requirements of this section that are 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 .57–.58 to be involved in the work of a component auditor. Therefore, the group engagement team will not be able to obtain sufficient appropriate audit evidence regarding that component. The effect on the auditor's report of the group engagement team's inability to obtain sufficient appropriate audit evidence is considered in terms of section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

.A24 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.

.A25 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 inquiries and group management's representations to the group engagement team.

.A26 Section 210 addresses circumstances when an entity is required by law or regulation to have an audit.¹⁵ In these circumstances, this section 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 section 705.

.A27 Exhibit A, "Illustrations of Auditor's Reports on Group Financial Statements," 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 regarding a significant component accounted for by the equity method of accounting when, in the group engagement team's professional judgment, the effect is material but not pervasive.

Terms of Engagement (Ref: par. .17)

.A28 The terms of engagement identify the applicable financial reporting framework.¹⁶ Additional matters that may be included in the terms of a group audit engagement include whether reference will be made to the audit of a component auditor in the auditor's report on the group financial statements, when relevant, or arrangements to facilitate the following:

¹⁵ Paragraphs .07 and .A19 of section 210.

¹⁶ Paragraph .10 of section 210.

- Unrestricted communication between the group engagement team and component auditors to the extent permitted by law or regulation
- Communication to the group engagement team of important communications between
 - the component auditors, those charged with governance of the component, and component management, including communications on significant deficiencies and material weaknesses in internal control
 - regulatory authorities and components related to financial reporting matters
- To the extent the group engagement team considers necessary
 - 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)
 - permission to perform work, or request a component auditor to perform work, on the financial information of the components

.A29 Certain restrictions imposed after acceptance of the group audit engagement result in an inability to obtain sufficient appropriate audit evidence that may affect the group audit opinion including, specifically, restrictions imposed on the following:

- 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)
- The work to be performed on the financial information of the components

These restrictions may even lead to withdrawal from the engagement unless that is not possible under law or regulation. Section 705 addresses the auditor's responsibilities when management has imposed a limitation on the scope of the audit after the auditor has accepted the engagement.¹⁷

Overall Audit Strategy and Audit Plan (Ref: par. .19)

.A30 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: par. .20)

.A31 Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, contains guidance on matters the

¹⁷ Paragraphs .11–.14 and .A15–.A16 of section 705.

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.¹⁸ Appendix A, "Understanding the Group, Its Components, and Their Environments—Examples of Matters About Which the Group Engagement Team Obtains an Understanding," of this section contains guidance on matters specific to a group, including the consolidation process.

Instructions Issued by Group Management to Components (Ref: par. .20)

.A32 To achieve uniformity and comparability of financial information, group management ordinarily issues instructions to components. Such instructions specify the requirements for financial information of the components to be included in the group financial statements 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 statements. Reporting packages generally do not, however, take the form of complete financial statements prepared and presented in accordance with the applicable financial reporting framework.

.A33 The instructions ordinarily cover the following:

- The accounting policies to be applied
- Statutory and other disclosure requirements applicable to the group financial statements, including the following:
 - The identification and reporting of segments
 - Related party relationships and transactions
 - Intragroup transactions and unrealized profits or losses
 - Intragroup account balances
- A reporting timetable

.A34 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, related party transactions, and segment information)
 - provide for the identification of consolidation adjustments (for example, intragroup account balances, transactions, and unrealized profits or losses)
 - provide for the approval of the financial information by component management

¹⁸ Paragraphs .A17–.A41 of section 315.

Fraud (Ref: par. .20)

.A35 The auditor is required to identify and assess the risks of material misstatement of the financial statements due to fraud and to design and implement appropriate responses to the assessed risks.¹⁹ Information used to identify the risks of material misstatement of the group financial statements due to fraud may include the following:

- Group management's assessment of the risks that the group financial statements 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 particular components exist 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, appropriate individuals within the internal audit function (and, if considered appropriate, component management, the component auditors, and others) to the group engagement team's inquiry whether they have knowledge of any actual, suspected, or alleged fraud affecting a component or the group

[As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

Discussion Among Group Engagement Team Members and Component Auditors Regarding the Risks of Material Misstatement of the Group Financial Statements, Including Risks of Fraud (Ref: par. .20)

.A36 The key members of the engagement team are required to discuss the susceptibility of an entity to material misstatement of the financial statements due to fraud or error, specifically emphasizing the risks due to fraud. In a group audit, these discussions also may include the component auditors.^{20, 21} 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.

.A37 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 statements may be susceptible to material misstatement due to fraud or error; how group management and component management

¹⁹ See section 240, *Consideration of Fraud in a Financial Statement Audit*.

²⁰ Paragraph .15 of section 240.

²¹ Paragraph .11 of section 315.

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 rationalize committing fraud.
- 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 statements and, if not, how differences in accounting policies are identified and adjusted (when required by the applicable financial reporting framework).
- discuss fraud that has been identified in components or information that indicates the existence of a fraud in a component.
- share information that may indicate noncompliance with laws or regulations (for example, payments of bribes and improper transfer pricing practices).

Risk Factors (Ref: par. .21)

.A38 Appendix B, "Examples of Conditions or Events That May Indicate Risks of Material Misstatement of the Group Financial Statements," sets out examples of conditions or events that, individually or together, may indicate risks of material misstatement of the group financial statements, including risks due to fraud.

Risk Assessment (Ref: par. .21)

.A39 The group engagement team's assessment at group level of the risks of material misstatement of the group financial statements 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 a Component Auditor (Ref: par. .22)

Group Engagement Team's Procedures to Obtain an Understanding of a Component Auditor and Sources of Audit Evidence (Ref: par. .22)

.A40 Factors that may affect the group engagement partner's decisions whether to use the work of a component auditor to provide audit evidence for

the group audit and whether to make reference to the audit of a component auditor in the auditor's report on the group financial statements include the following:

- Differences in the financial reporting framework applied in preparing the financial statements of the component and that applied in preparing the group financial statements
- Whether the audit of the financial statements of the component will be completed in time to meet the group reporting timetable
- Differences in the auditing and other standards applied by the component auditor and those applied in the audit of the group financial statements
- Whether it is impracticable for the group engagement team to be involved in the work of a component auditor

.A41 It will not be necessary to obtain an understanding of the auditors of those components for which the group engagement team plans to perform analytical procedures at group level only.

.A42 The nature, timing, and extent of the group engagement team's procedures to obtain an understanding of a 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, such as the following:

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

.A43 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 auditor of the group financial statements, may be less than the extent of the group engagement team's procedures to obtain an understanding of component auditor B, who does not consistently apply common quality control and monitoring policies and procedures and a common audit methodology or operates in a different jurisdiction. The nature of the procedures performed regarding component auditors A and B also may be different.

.A44 The group engagement team may obtain an understanding of a component auditor in a number of ways. In the first year of involving a component auditor, the group engagement team may, for example

- determine through communication with a component auditor that
 - the component auditor is aware that
 - the financial statements of the component are to be included in the group financial statements on which the auditor of the group financial statements will report.
 - the component auditor's report thereon will be relied upon by the auditor of the group financial statements.
 - either the auditor of the group financial statements will make reference to the component auditor's report in the opinion on the group financial statements or the group engagement team will be involved in the work of the component auditor.
- a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.
- evaluate the results of the quality control monitoring system when the group engagement team and component auditor are from a firm or network that operates under, and complies with, common monitoring policies and procedures.²²
- visit a component auditor to discuss the matters in paragraph .22a–d.
- request a component auditor to confirm the matters referred to in paragraph .22a–d in writing. Exhibit B, "Illustrative Component Auditor's Confirmation Letter," contains an example of written confirmations by a component auditor.
- request a component auditor to complete questionnaires about the matters in paragraph .22a–d.
- discuss a component auditor with colleagues in the group engagement partner's firm or with a reputable third party that has knowledge of the component auditor, such as other practitioners or bankers and other credit grantors.

In subsequent years, the understanding of a component auditor may be based on the group engagement team's previous experience with that component auditor. The group engagement team may request the component auditor to confirm whether anything regarding the matters listed in paragraph .22a–d has changed since the previous year.

.A45 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 a component auditor. Information about the regulatory environment and the public results of any inspections performed by oversight bodies may be obtained from the component auditor or information provided by the independent oversight bodies.

²² Paragraph .57 of QC section 10, *A Firm's System of Quality Control*.

Ethical Requirements That Are Relevant to the Group Audit (Ref: par. .22a)

.A46 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 an audit in the component auditor's jurisdiction. The group engagement team, therefore, obtains an understanding about the component auditor's understanding of, and compliance with, the ethical requirements that are relevant to the group audit and whether that is sufficient to fulfill the component auditor's responsibilities in the group audit. When the component auditor is not subject to the AICPA Code of Professional Conduct, compliance by the component auditor with the ethics and independence requirements set forth in the International Federation of Accountants *Code of Ethics for Professional Accountants* is sufficient to fulfill the component auditor's ethical responsibilities in the group audit.²³

A Component Auditor's Professional Competence (Ref: par. .22b)

.A47 Inquiries about the professional reputation and standing of a component auditor may be made of the AICPA, the state board of accountancy by which the component auditor is licensed, the applicable state society of CPAs, or the local chapter, or, in the case of an auditor from a foreign jurisdiction, the corresponding professional organization, and if applicable, the PCAOB. The group engagement team may obtain the peer review report, if available, on the component auditor's firm. Exhibit C, "Sources of Information," provides information about specific inquiries that may be directed to the AICPA.

.A48 The group engagement team's understanding of a component auditor's professional competence may include whether the component auditor

- possesses an understanding of the auditing and other standards applicable to the group audit, such as U.S. GAAS, that is sufficient to fulfill the component auditor's responsibilities.
- possesses the special skills (for example, industry-specific knowledge or knowledge of relevant financial reporting requirements for statements and schedules to be filed with regulatory agencies) necessary to perform the work on the financial information of the particular component.
- when 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).

Application of the Group Engagement Team's Understanding of a Component Auditor (Ref: par. .23)

.A49 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

²³ ET section 0.200.020, *Application of the AICPA Code*, of the AICPA Code of Professional Conduct explains that an AICPA member who is the group engagement partner of a U.S. consolidated entity should be considered to have performed an audit in accordance with generally accepted auditing standards, and in compliance with the AICPA Code of Professional Conduct, provided that component auditors that are not subject to the AICPA Code are in compliance with the ethics and independence requirements set forth in the International Federation of Accountants Code of Ethics. [Footnote revised, January 2015, to reflect conforming changes necessary due to the issuance of the revised AICPA Code of Professional Conduct, effective December 15, 2014.]

on the financial information of the component or by making reference in the auditor's report on the group financial statements to the audit of the component auditor.

.A50 However, the group engagement team may be able to overcome less than serious concerns about a component auditor's professional competency (for example, lack of industry-specific knowledge) or the fact that a component auditor does not operate in an environment that actively oversees auditors by being involved in the work of that component auditor or by performing additional risk assessment or further audit procedures on the financial information of the component.

.A51 When law or regulation prohibits access to relevant parts of the audit documentation of a component auditor, the group engagement team may request the component auditor to overcome this by preparing a memorandum that covers the relevant information.

Determining Whether to Make Reference to a Component Auditor in the Auditor's Report on the Group Financial Statements (Ref: par. .24)

.A52 In group audits involving two or more component auditors, the decision to make reference to the audit of a component auditor is made individually for each component auditor, regardless of the decision whether to refer to any other component auditor. The auditor of the group financial statements may make reference to any, all, or none of the component auditors. For example, if significant components are audited by a component auditor from a network firm and one component is audited by another firm, the group engagement partner may decide to assume responsibility for the work of the component auditor from the network firm and to make reference to the work of the component auditor from the other firm.

Determining Whether the Audit Was Conducted in Accordance With GAAS (Ref: par. .25a)

.A53 A component auditor's report stating that the audit was conducted in accordance with GAAS or, if applicable, the auditing standards promulgated by the PCAOB is sufficient to make the determination required by paragraph .25a. When the component auditor has performed an audit of the component financial statements in accordance with auditing standards other than GAAS or, if applicable, the auditing standards promulgated by the PCAOB, the group engagement partner may evaluate, exercising professional judgment, whether the audit performed by the component auditor meets the relevant requirements of GAAS. For the purposes of complying with paragraph .25a, relevant requirements of GAAS are those that pertain to planning and performing the audit of the component financial statements and do not include those related to the form of the auditor's report. Audits performed in accordance with International Standards on Auditing (ISAs) promulgated by the International Auditing and Assurance Standards Board (IAASB) are more likely to meet the relevant requirements of GAAS than audits performed in accordance with auditing standards promulgated by bodies other than the IAASB. The group engagement team may provide the component auditor with appendix B, *Substantive Differences Between the International Standards on Auditing and Generally Accepted Auditing Standards*, that identifies substantive requirements of GAAS that are not requirements in the ISAs. The component auditor may perform additional procedures in order to meet the relevant requirements of GAAS. The

communication requested of the component auditor required by paragraph .42 may address whether the audit of the component auditor met the relevant requirements of GAAS. The group engagement partner, having determined that all relevant requirements of GAAS have been met by the component auditor, may decide to make reference to the audit of that component auditor in the auditor's report on the group financial statements. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Determining Whether to Make Reference When the Financial Reporting Framework Is Not the Same (Ref: par. .26)

.A54 When the component's financial statements are prepared using a financial reporting framework that differs from the financial reporting framework used to prepare the group financial statements, the group engagement team is required by paragraph .37 to evaluate whether the financial information of the component has been appropriately adjusted for purposes of the preparation and fair presentation of the group financial statements in accordance with the applicable financial reporting framework. Evaluating whether the financial statements of the component have been appropriately adjusted to conform with the financial reporting framework used by the group is based on a depth of understanding of the component's financial statements that ordinarily is not obtained unless the auditor of the group financial statements assumes responsibility for, and, thus, is involved in, the work of the component auditor. In rare circumstances, however, the group engagement partner may conclude that the group engagement team can reasonably expect to obtain sufficient appropriate audit evidence for purposes of evaluating the appropriateness of the adjustments to convert the component's financial statements to the financial reporting framework used by the group without the need to assume responsibility for, and, thus, be involved in, the work of the component auditor. [Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A55 The greater the number of differences or the greater the significance of the differences between the criteria used for measurement, recognition, presentation, and disclosure of all material items in the component's financial statements under the financial reporting framework used by the component and the financial reporting framework used by the group, the less similar they are. Financial statements prepared and presented in accordance with International Financial Reporting Standards (IFRSs) and *International Financial Reporting Standard for Small and Medium-sized Entities*, as issued by the International Accounting Standards Board, are generally viewed as more similar to financial statements prepared and presented in accordance with accounting principles generally accepted in the United States of America (GAAP) than financial statements prepared and presented in accordance with jurisdiction-specific reporting frameworks or adaptations of IFRSs. In most cases, special purpose frameworks set forth in section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, are not similar to GAAP. [Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A56 Additional considerations in determining whether it may be appropriate to make reference to the audit of a component auditor in the auditor's report on the group financial statements when the component prepares financial statements using a different financial reporting framework than that used by the group include the

- effectiveness of groupwide controls and the adequacy of the consolidation process specifically related to the adjustments to convert the component's financial statements to the financial reporting framework used by the group, including the financial reporting competencies of personnel involved in the adjustments.
- depth of the group engagement team's understanding of the component and its environment, including the complexity of the events and transactions subject to the differing financial reporting requirements and the assessed risk of material misstatement related to the adjustments.
- extent of the group engagement team's knowledge of the financial reporting framework used to prepare the component financial statements.
- group engagement team's ability to obtain information from group or component management that is relevant to the adjustments.
- need and ability to seek, as necessary, the assistance of professionals possessing specialized skills or knowledge related to the adjustments.

[Paragraph added, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Considerations for Governmental Entities

.A57 When the applicable financial reporting framework used by the group provides for the inclusion of component financial statements that are prepared in accordance with a different financial reporting framework, the component financial statements are deemed to be in accordance with the applicable financial reporting framework used for the group financial statements. For example, both the financial reporting framework established by the Governmental Accounting Standards Board and the financial reporting framework established by the Federal Accounting Standards Advisory Board have such provisions. Accordingly, when the provisions established by the applicable financial reporting framework for inclusion of those component financial statements have been followed, the requirements in paragraphs .26 and .28c are not relevant. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

Making Reference in the Auditor's Report (Ref: par. .28-.31)

.A58 The disclosure of the magnitude of the portion of the financial statements audited by a component auditor may be achieved by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly describes the portion of the financial statements audited by a component auditor. When two or more component auditors participate in the audit, the dollar amounts or the percentages covered by the component auditors may be stated in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A59 Reference in the auditor's report on the group financial statements to the fact that part of the audit was conducted by a component auditor is not to be construed as a qualification of the opinion, but rather is intended to communicate (1) that the auditor of the group financial statements is not assuming responsibility for the work of the component auditor, and (2) the source of the audit evidence with respect to those components for which reference to the

audit of component auditors is made. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A60 Exhibit A contains examples of appropriate reporting in the auditor's report on the group financial statements when reference is made to the audit of a component auditor. [Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

.A61 If the modified opinion, emphasis-of-matter paragraph, or other-matter paragraph in the component auditor's report does not affect the report on the group financial statements and the component auditor's report is not presented, the auditor of the group financial statements need not make reference to those paragraphs in the auditor's report on the group financial statements. If the component auditor's report is presented, the auditor of the group financial statements may make reference to those paragraphs and their disposition. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A62 When the auditor of the group financial statements is assuming responsibility for the work of a component auditor, no reference is made to the component auditor in the report on the group audit because to do so may cause a reader to misinterpret the degree of responsibility being assumed. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Materiality (Ref: par. .32)

.A63 The auditor is required²⁴

- a. when establishing the overall audit strategy
 - i. to determine materiality for the financial statements as a whole.
 - ii. to consider whether, in the specific circumstances of the entity, particular classes of transactions, account balances, or disclosures exist for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. In such circumstances, the auditor determines materiality to be applied to those particular classes of transactions, account balances, or disclosures.
- b. to determine performance materiality 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 is established for both the group financial statements as a whole and the financial information of those components on which the group engagement team will perform, or request a component auditor to perform, an audit or review. Materiality for the group financial statements as a whole is used when establishing the overall group audit strategy. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A64 Different materiality may be established for different components. The aggregate of component materiality may exceed group materiality. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A65 Consideration of all components, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of

²⁴ Paragraphs .10–.11 of section 320.

a component auditor, is necessary when determining component materiality to reduce the risk that the aggregate of detected and undetected misstatements in the group financial statements exceeds materiality for the group financial statements as a whole. Determining component materiality is necessary for the group engagement team to determine the overall group audit plan for the components for which the auditor of the group financial statements is not making reference to the component auditor. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A66 When the component is subject to an audit required by law or regulation or performed for another reason, the materiality used by the component auditor for purposes of such audit ordinarily can be expected to be less than the group materiality and, accordingly, be acceptable for purposes of the group audit. In the case of an equity method investment, the investee may be larger than the investor, and the auditor's evidence to support the investor's share of earnings from the investment may consist largely of the audited financial statements of the investee. In such cases, the materiality used by the investee's auditor may be larger than the materiality used by the investor's auditor. When such circumstances exist, the group engagement team may take into consideration matters such as the group's ownership percentage and its share of the investee's profits and losses when determining whether the component materiality used by the investee's auditor is appropriate for purposes of the audit of the group financial statements. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A67 A threshold for misstatements is determined in addition to component materiality. Misstatements identified in the financial information of the component that are above the threshold for misstatements of the group are communicated to the group engagement team. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Responding to Assessed Risks (Ref: par. .33)

.A68 In an audit of group financial statements, appropriate responses to assessed risks of material misstatement for some or all accounts or classes of transactions may be implemented at the group level, without the involvement of component auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Consolidation Process

Consolidation Adjustments and Reclassifications (Ref: par. .36)

.A69 The consolidation process may require adjustments to amounts reported in the group financial statements 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 the following:

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

- Checking the reconciliation and elimination of intragroup account balances, transactions, and unrealized profits or losses
- Communicating with the component auditor, regardless of whether reference is made in the auditor's report on the group financial statements to the audit of the component auditor.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Subsequent Events (Ref: par. .40)

.A70 When the auditor's report on the group financial statements will make reference to the audit of a component auditor, procedures designed to identify subsequent events between the date of the component auditor's report and the date of the auditor's report on the group financial statements may include

- obtaining an understanding of any procedures that group management has established to ensure that such subsequent events are identified.
- requesting the component auditor to update subsequent events procedures to the date of the auditor's report on the group financial statements.
- requesting written representation from component management regarding subsequent events.
- reading available interim financial information of the component and making inquiries of group management.
- reading minutes of meetings of the governing board, or any other administrative board with management oversight, held since the financial statement date.
- reading the subsequent year's capital and operating budgets.
- inquiring of group management regarding currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations for items that represent subsequent events.
- considering the implications for the auditor's report on the group financial statements if the group engagement team has been unable to obtain sufficient appropriate audit evidence regarding subsequent events.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Sufficiency and Appropriateness of Audit Evidence (Ref: par. .44–.45)

.A71 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 a component auditor to perform additional procedures. Alternatively, the group engagement team may perform its own procedures on the financial information of the component. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A72 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 statements as a whole are materially misstated. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Group Management and Those Charged With Governance of the Group

Communication With Group Management (Ref: par. .46–.48)

.A73 Section 240, *Consideration of Fraud in a Financial Statement Audit*, contains requirements and guidance on communication of fraud to management and, when management may be involved in the fraud, those charged with governance.²⁵ [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A74 Group management may need to keep certain material sensitive information confidential. Examples of matters that may be significant to the financial statements 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

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With Those Charged With Governance of the Group (Ref: par. .49)

.A75 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 .49a–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 .49c may be communicated at the end of the audit, and the matters referred to in paragraph .49d–e may be communicated when they occur. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Additional Requirements Applicable When Assuming Responsibility for the Work of a Component Auditor

Materiality (Ref: par. .51)

.A76 Component materiality for those components whose financial information will be audited or reviewed as part of the group audit in accordance

²⁵ Paragraphs .39–.41 of section 240.

with paragraphs .53, .54a, and .56, is communicated to the component auditor and is used by the component auditor to evaluate whether uncorrected detected misstatements are material, individually or in the aggregate. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A77 In the case of an audit of the financial information of a component, section 320, *Materiality in Planning and Performing an Audit*, requires the component auditor (or group engagement team) to determine performance 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.²⁶ This is necessary to reduce the risk that the aggregate of detected and undetected misstatements in the financial information of the component exceeds component materiality. In practice, the group engagement team may set component materiality at the level of performance materiality for the component. When 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. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

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

Significant Components (Ref: par. .53–.54)

.A78 Adapting an audit of the financial information of a significant component to meet the specific needs of the group engagement team may include requesting the component auditor to

- perform an audit, using component materiality, in accordance with GAAS, with the exception of performing audit procedures on, for example, tax accounts or litigation, claims, and assessments because those procedures are performed at the group level.
- communicate the results of the audit in a form that is responsive to the needs of the group engagement team.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

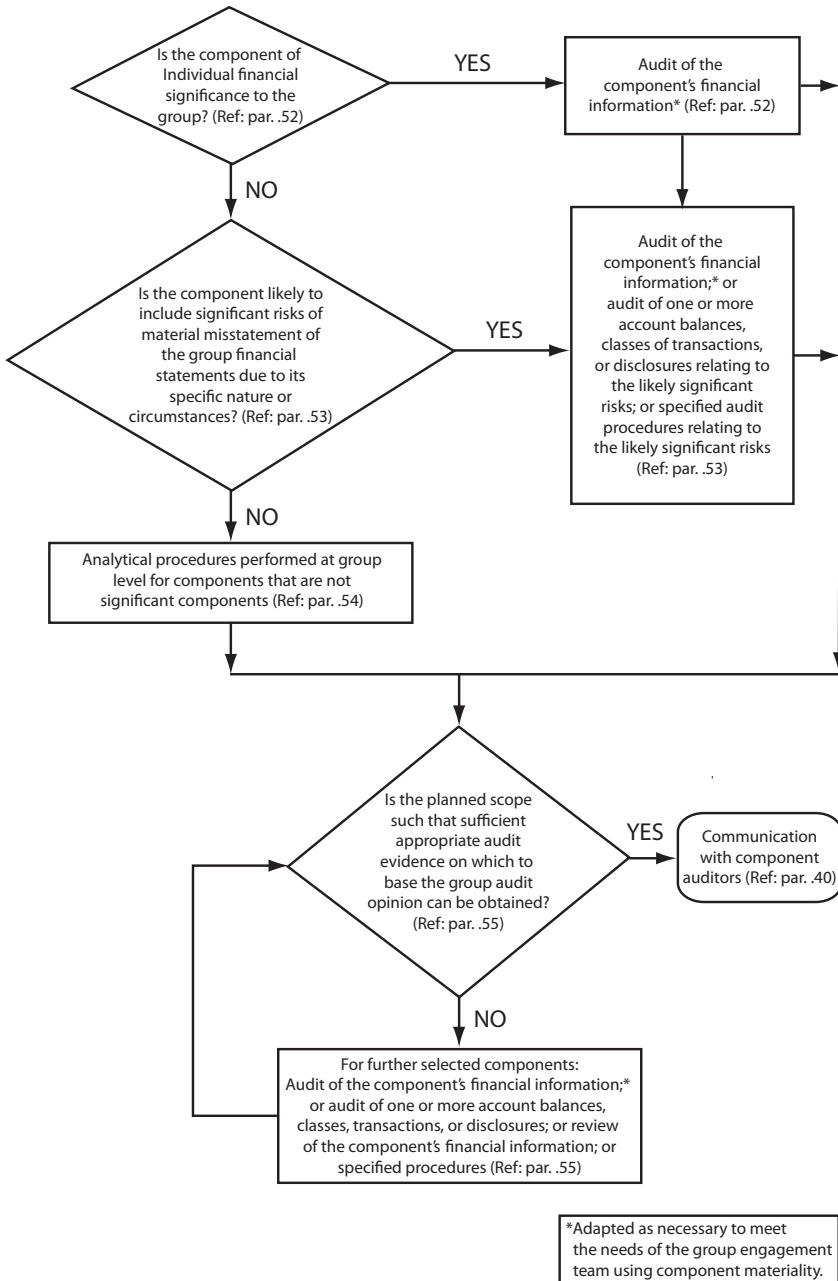
.A79 The group engagement team's determination of the type of work to be performed on the financial information of a component and its involvement in the work of the component auditor is affected by the following:

- a. The significance of the component
- b. The identified significant risks of material misstatement of the group financial statements
- c. The group engagement team's evaluation of the design of group-wide controls and the determination of whether they have been implemented
- 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.

²⁶ Paragraph .11 of section 320.

Using the Work of Others



[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A80 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 statements 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. When this is the case, the group engagement team may decide to perform or request a component auditor to perform an audit, adapted as necessary to meet the needs of the group engagement team, of only those account balances, classes of transactions, or disclosures. For example, in the situation described in paragraph .A7, 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. When 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 .41) takes account of the fact that many financial statement items are interrelated. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A81 The group engagement team may design audit procedures that respond to a likely significant risk of material misstatement of the group financial statements. 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. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Components That Are Not Significant Components (Ref: par. .55–.56)

.A82 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 no significant risks of material misstatement exist of the aggregated financial information of components that are not significant components. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A83 The group engagement team's decision about how many components to select in accordance with paragraph .56, which components to select, and the type of work to be performed on the financial 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 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 an audit required by law or regulation or performed 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. [Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A84 An audit of a component that is not a significant component may have already been performed. Once the group engagement team decides to use that work to provide audit evidence for the group audit, the provisions of this section apply. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A85 A review of the financial information of a component may be performed in accordance with Statements on Standards for Accounting and Review Services, adapted as necessary in the circumstances. A review is designed to obtain only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. The group engagement team also may specify additional procedures to supplement this work. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A86 As explained in paragraph .A19, 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 .56. 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. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Involvement in the Work Performed by Component Auditors ***(Ref: par. .57–.58)***

.A87 Factors that may affect the group engagement team's involvement in the work of a component auditor include the following:

- a. The significance of the component
- b. The identified significant risks of material misstatement of the group financial statements
- 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 .57–.58. 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 concerns (although less than serious concerns) about the component auditor's professional competency (for example, lack of industry-specific knowledge), or the component auditor does not operate in an environment that actively oversees auditors. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A88 Forms of involvement in the work of a component auditor other than those described in paragraphs .43 and .57–.58 may, based on the group engagement team's understanding of the component auditor, include one or more of the following:

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

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Communication With a Component Auditor (Ref: par. .60)

.A89 If effective two-way communication does not exist between the group engagement team and component auditors, whose work the auditor of the group financial statements is assuming responsibility for, a risk exists 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 a component auditor. This two-way communication also may be initiated by the component auditor regarding matters that may be significant to the component audit such as

- transactions, adjustments, or other matters that have come to the group engagement team's attention that it believes require adjustment to or disclosure in the financial statements of the component being audited by the component auditor.
- any relevant limitation on the scope of the audit performed by the group engagement team.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A90 The group engagement team's requirements often are communicated in a letter of instruction. Appendix C, "Required and Additional Matters Included in the Group Engagement Team's Letter of Instruction," contains guidance on required and additional matters that may be included in such a letter of instruction. A 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 a 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 section and other AU-C sections apply. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A91 In cooperating with the group engagement team, a component auditor, for example, would provide the group engagement team with access to relevant audit documentation, if not prohibited by law or regulation. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A92 When 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 often can 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 .41.
- a review of the component auditor's audit documentation by the group engagement team may be sufficient to communicate matters relevant to the group engagement team's conclusion set out in paragraph .42.

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

Evaluating the Sufficiency and Appropriateness of Audit Evidence Obtained

Reviewing a Component Auditor's Audit Documentation (Ref: par. .62)

.A93 The parts of the audit documentation of a component auditor that 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 statements. The extent of the review may be affected by the fact that a component auditor's audit documentation has been subjected to the review procedures of the component auditor's firm. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A94

Appendix A—Understanding the Group, Its Components, and Their Environments—Examples of Matters About Which the Group Engagement Team Obtains an Understanding (Ref: par. .A31)

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

Group-wide controls may include a combination of the following:

- Regular meetings between group and component management to discuss business developments and 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 take appropriate action
- Group management's risk assessment process (that is, the process for identifying, analyzing, and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial statements)
- Monitoring, controlling, reconciling, and eliminating intragroup account balances, transactions, and unrealized profits or losses 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 are common for all or some components
- Monitoring of controls, including activities of the internal audit function 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

The internal audit function may be regarded as part of group-wide controls, for example, when the function is centralized. Section 610, *Using the Work of Internal Auditors*, addresses the group engagement team's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the function applies a

systematic and disciplined approach when the group engagement team expects to use the function's work.¹

Consolidation Process

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, such as the following:
 - 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
 - The accounting policies applied to the group financial statements, 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, such as the following:
 - Group management's process for obtaining an understanding of the accounting policies used by components and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the components for the group financial statements and that differences in accounting policies are identified and adjusted, when 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.

¹ Paragraphs .14–.15 of section 610, *Using the Work of Internal Auditors*. [Footnote amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

- The process for translating the financial information of foreign components into the currency of the group financial statements.
- How IT is organized 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.
- Matters relating to consolidation adjustments, such as the following:
 - The process for recording consolidation adjustments, including the preparation, authorization, 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 intragroup account balances, transactions, and unrealized profits or losses
 - Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortizing goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework
 - Arrangements with a controlling interest or noncontrolling interest regarding losses incurred by a component (for example, an obligation of the noncontrolling interest to compensate such losses)

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A95

Appendix B—Examples of Conditions or Events That May Indicate Risks of Material Misstatement of the Group Financial Statements (Ref: par. .A38)

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 following list of examples is not necessarily complete:

- A complex group structure, especially when there are frequent acquisitions, disposals, or reorganizations
- Poor corporate governance structures, including decision-making processes, that are not transparent
- Nonexistent 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, 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 requires incorporation in the group financial statements, in accordance with the applicable financial reporting framework (for example, whether any special purpose entities or nontrading entities exist and require incorporation)
- Unusual related party relationships and transactions
- Prior occurrences of intragroup account balances that did not balance or reconcile on consolidation
- The existence of complex transactions that are accounted for in more than one component
- Components' application of accounting policies that differ from those applied to the group financial statements
- Components with different financial year-ends, which may be utilized to manipulate the timing of transactions
- Prior occurrences of unauthorized 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 statements of components

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A96

Appendix C—Required and Additional Matters Included in the Group Engagement Team’s Letter of Instruction (Ref: par. .A87)

The following matters are relevant to the planning of the work of a component auditor:

[Required matters are italicized.]

- *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*
- *In the case of an audit or review of, or specified audit procedures performed on, the financial information of the component, the threshold above which misstatements cannot be regarded as clearly trivial to the group financial statements*
- *A list of related parties prepared by group management and any other related parties of which the group engagement team is aware 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*
- Work to be performed on intragroup account balances, transactions, and unrealized profits or losses
- Guidance on other statutory reporting responsibilities (for example, reporting on group management's assertion on the effectiveness of internal control)
- When a 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 statements is likely, specific instructions for a subsequent events review

The following matters 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 statements, 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 statements, due to fraud or error; identified in the component and the component auditor's response to such risks*
- The findings of the internal audit function, 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 statements have been disclosed
- Matters to be documented by the component auditor

Other information, such as the following:

- 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 judgments
 - 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 .49 be communicated to the group engagement team when the work on the financial information of the component is completed

[Paragraph renumbered by the issuance of SAS No. 127, January 2013. As amended, effective for audits of financial statements for periods ending on or after December 15, 2014, by SAS No. 128.]

.A97

Exhibit A—Illustrations of Auditor’s Reports on Group Financial Statements

Illustration 1—A Report With a Qualified Opinion When the Group Engagement Team Is Not Able to Obtain Sufficient Appropriate Audit Evidence on Which to Base the Group Audit Opinion (Ref: par. .A27)

Illustration 2—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards (Ref: par. .A60)

Illustration 3—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS (Ref: par. .A60)

Illustration 4—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS (Ref: par. .A60)

Illustration 1 — A Report With a Qualified Opinion When 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 because the group engagement team was unable to obtain the audited financial statements of the component as of December 31, 20X1 and 20X0, including the auditor's report thereon. In this example, the auditor of the group financial statements is not making reference to the report of a component auditor.

In the auditor's professional judgment, the effect on the group financial statements of this inability to obtain sufficient appropriate audit evidence is material but not pervasive.

If, in the auditor's professional judgment, the effect on the group financial statements of the inability to obtain sufficient appropriate audit evidence is material and pervasive, the auditor would disclaim an opinion, in accordance with section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we 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 judgment, 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

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.² Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$_____ and \$_____ at December 31, 20X1 and 20X0, respectively, or its equity in earnings of that affiliate of \$_____ and \$_____, which is included in net income for the years then ended as described in Note X to the consolidated financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

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 referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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]

[Auditor's city and state]

[Date of the auditor's report]

² 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 addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

Illustration 2—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Generally Accepted Auditing Standards

In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with generally accepted auditing standards (GAAS).

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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 judgment, including the assessment of the risks of material misstatement of the consolidated financial statements,

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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 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.² Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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 audit opinion.

Opinion

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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]

[Auditor's city and state]

[Date of the auditor's report]

² 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 addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

Illustration 3—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using a Different Financial Reporting Framework From That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With GAAS

In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using a different financial reporting framework than that used for the group financial statements and performed by a component auditor in accordance with GAAS.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements, which were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, were audited by other auditors, whose report has been furnished to us. We have applied audit procedures on the conversion adjustments to the financial statements of B Company, which conform those financial statements to accounting principles generally accepted in the United States of America. Our opinion, insofar as it relates to the amounts included for B Company, prior to these conversion adjustments, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

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 judgment, 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 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.² Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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 audit opinion.

Opinion

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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]

[Auditor's city and state]

[Date of the auditor's report]

² 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 addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

Illustration 4—A Report in Which the Auditor of the Group Financial Statements Is Making Reference to the Audit of the Financial Statements of a Component Prepared Using the Same Financial Reporting Framework as That Used for the Group Financial Statements and Performed by a Component Auditor in Accordance With Auditing Standards Other Than GAAS

In this example, the auditor of the group financial statements is making reference to the audit of the financial statements of a component prepared using the same financial reporting framework as that used for the group financial statements and performed by a component auditor in accordance with auditing standards other than GAAS or standards promulgated by the Public Company Accounting Oversight Board. The group engagement partner has determined that the component auditor performed additional audit procedures to meet the relevant requirements of GAAS. If additional procedures were not necessary for the audit of the component auditor to meet the relevant requirements of GAAS, illustration 2 is applicable.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Consolidated Financial Statements¹

We have audited the accompanying consolidated financial statements of ABC Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X1 and 20X0, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of 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.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X1 and 20X0, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. Those statements were audited by other auditors in accordance with *[describe the set of auditing standards]*, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of, and additional audit procedures to meet the relevant requirements of auditing standards generally accepted in the United States

¹ The subtitle "Report on the Consolidated Financial Statements" is unnecessary in circumstances when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable.

of America performed by, the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of 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 judgment, 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 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.² Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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 audit opinion.

Opinion

In our opinion, based on our audits and the report of, and additional audit procedures performed by, the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company and its subsidiaries as of December 31, 20X1 and 20X0, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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]

[Auditor's city and state]

[Date of the auditor's report]

[Paragraph renumbered and amended, effective for audits of group financial statements for periods ending on or after December 15, 2012, by SAS No. 127.]

² 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 addition, the next sentence, "Accordingly, we express no such opinion." would not be included.

.A98

Exhibit B—Illustrative Component Auditor’s Confirmation Letter (Ref: par. .A44)

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. In this example, confirmations expected only when the auditor of the group financial statements is assuming responsibility have been italicized.

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

[Component Auditor Letterhead]

[Date]

[To Audit Firm]

This letter is provided in connection with your audit of the group financial statements of *[name of parent]* as of and for the year ended *[date]* for the purpose of expressing an opinion on whether the group financial statements present fairly, in all material respects, the financial position of the group as of *[date]* and of the results of its operations and its 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]* as of and 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.*

We acknowledge that:

1. *The financial information of [name of component] will be included in the group financial statements of [name of parent].*
2. *You may consider it necessary to be further involved in the work you have requested us to perform on the financial information of [name of component] as of and for the year ended [date].*
3. *You intend to evaluate and, if considered appropriate, use our work for the audit of the group financial statements 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 statements 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 auditing standards generally accepted in the United States of America and [*indicate other auditing standards applicable to the audit of the group financial statements, such as Government Auditing Standards*] that is sufficient to fulfill our responsibilities in the audit of the group financial statements and will conduct our work on the financial information of [*name of component*] as of and 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 statements.

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*].

[*Auditor's signature*]

Illustration of Potential Component Auditor Representations in Governmental Entities and Not-for-Profit Organizations

5. We have an understanding of relevant laws and regulations that may have a direct and material effect on the financial statements of [*name of component*]. In particular, we have an understanding of [*indicate relevant laws and regulations*].

[Paragraph renumbered by the issuance of SAS No. 127, January 2013.]

.A99

Exhibit C—Sources of Information (Ref: par. .A47)

The AICPA Professional Ethics Team can respond to inquiries about whether individuals are members of the AICPA and whether complaints against members have been adjudicated by the Joint Trial Board. The team cannot respond to inquiries about public accounting firms or provide information about letters of required corrective action issued by the team or pending disciplinary proceedings or investigations. The AICPA Peer Review Program staff or the applicable state CPA society administering entity can respond to inquiries about whether specific public accounting firms are enrolled in the AICPA Peer Review Program and the date of acceptance and the period covered by the firm's most recently accepted peer review. [Paragraph renumbered by the issuance of SAS No. 127, January 2013.]
