

HOT SPOT

Auditing Standard SA-600



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Is there need for Re-Audit of component by group auditor?

An unmodified opinion of the auditor in the audit report on the financial statements of the Company gives comfort to the users/stakeholders/shareholders that the said financial statements gives true and fair view of the financial position of the Company and are free from material misstatements. Great value and trust are placed upon the work done by the auditors and auditors reports, however, few corporate frauds which have come to light in recent times has resulted in a significant trust deficit and questions are being raised on the work done by the fraternity as a whole. This issue was particularly highlighted during the NFRA review of the audits of Coffee Day Global Limited.

One such matter which is being debated is quality of group audit and the responsibility of the auditor of the holding company (or group auditor) and how much reliance can be placed on the work done by the component auditors. Standard on Auditing 600 deals with audit of group consolidated financial statements by the auditors of holding Company.

The subsequent contents of this article summarises the current auditing standard, rights & obligations under the Companies Act

and the changes which are proposed by NFRA and its potential impact/implications.

Rights and obligations of auditor of the holding company under the Companies Act

Section 143 of the Companies Act, 2013 mentions that the auditor of the holding company shall have access to the records of all the subsidiaries and associates in so far as it relates to the consolidation of its financial statements with that of its subsidiaries. This right itself brings lot of responsibility on the shoulders of the auditor of the holding company as far as consolidated financial statements are concerned.

SA 600 – Using the work of another auditor

This auditing standard is effective from 1st April 2002 and provides clear guidelines as regards the procedure to be followed by the group auditor. These guidelines include the following.

- Materiality of the portion of the financial information which is audited by the principal auditor.
- Obtaining sufficient and appropriate audit evidence as regards the work performed by the component auditors.

- Emphasis on the communication between the auditors including informing the component auditors as regards the critical audit areas and specific audit procedures (if any). Generally, there is a practice to issue group audit instructions which include specific questions to determine the appropriateness of work done by the component auditors.
- Observations/findings of the component auditors are required to be considered while forming an opinion on the consolidated financial statements.

Standard states that the principal auditor would not be responsible for the work done by the component auditor except in circumstances which should have aroused suspicion as regards reliability of work done. Also, the group auditor is required to clearly state as regards his reliance on the work done by component auditors.

Over the last 2 decades the procedures and implementation of this standard has come a long way and in general has given good results except for a few cases of fraud which have been reported in last few years.

Proposed changes by NFRA

The proposed draft of SA 600 by NFRA is replica/adoption of ISA 600 (revised) which is effective from 15th December 2023.

These changes are proposed to be made applicable to public interest entities which are covered under NFRA except for Public Sector Enterprises, Public Sector Insurance Companies, Public Sector Banks, and their respective branches.

Key highlights of ISA 600 (revised) - Special Considerations—Audits of Group Financial Statements (Including the Work of Component

Auditors) which contains 59 paras, 182 explanatory paras and corresponding changes in existing ISAs related to audit reports, quality management, audit documentation, etc.

- Auditor's report on the group financial statements shall not refer to a component auditor, unless required by law or regulation. Even if the reference is made that does not diminish the group engagement partner's or the group engagement partner's firm's responsibility for the group audit opinion.
- Although component auditors may perform work on the financial information of the components for the group audit and as such are responsible for their overall findings or conclusions, the group engagement partner or the group engagement partner's firm is responsible for the group audit opinion.
- ISA 600 additionally requires a group auditor to establish an overall group audit strategy and group audit plan including components at which audit will be performed. In doing so, the group auditor shall evaluate whether they will be able to be sufficiently and appropriately involved in the work of the component auditor.
- Group engagement partner is required to sufficiently be involved throughout the group audit and in the work of the component auditor.

Accordingly, there would be additional responsibility on group auditor for identifying, assessing, and responding to risk of material misstatement at group level reporting, evaluating the component auditor's communication and adequacy of their work, evaluating sufficiency and appropriateness of

audit evidence obtained and documentation thereof.

The above change upgrades the current auditing standard to the internationally accepted practices and should be welcome by the stakeholders in general.

Potential challenges/issues from India perspective

- In India auditing practice is carried out by large number of firms which are scattered and many of them are not very large. Large corporation would prefer only a single auditor across the group to reduce the additional time & efforts. This may lead to concentration of audits with few large firms.
- There could be substantial increase in audit fees on account of increased responsibilities which would require additional audit procedures, documentation and overall increase in time cost.
- Adherence to timelines could also be a challenge as principal auditor may reperform some of the audit procedures

- Two different auditing standards – one for public interest entities and one for entities not covered by the new standard.

The auditing fraternity should review the standard in detail and provide their feedback before the due date for public comments and government (NFRA) should give due weightage to the public comments/suggestions and concerns before the final roll out. Some carveouts and exceptions to suit the Indian environment should be considered.

The intent and the rationale of the proposed change is well understood however whether it would result into improved perception about audit quality needs to be seen. Also, whether these changes address the root cause or lead to additional documentation.

It should also be considered whether mandatory joint audits for public interest entities could be a better way forward.



“Work for work's sake. There are some who are really the salt of the earth in every country and who work for work's sake, who do not care for name, or fame, or even to go to heaven.”

— Swami Vivekananda