

Appendix 2

(Ref: Para. A85)

Understanding the Group’s System of Internal Control

60. This appendix provides examples of matters related to internal control that may be helpful in obtaining an understanding of the system of internal control in the context of a group environment, and expands on how ASA 315⁹⁷ is to be applied in relation to an audit of a group financial report. The examples may not be relevant to every group audit engagement and the list of examples is not necessarily complete.

Control Environment

61. The group auditor’s understanding of the control environment may include matters such as the following:
- The structure of the governance and management functions across the group, and group management’s oversight responsibilities, including arrangements for assigning authority and responsibility to management of entities or business units in the group.
 - How oversight over the group’s system of internal control by those charged with governance is structured and organised.
 - How ethical and behavioural standards are communicated and reinforced in practice across the group, (e.g., group-wide programs, such as codes of conduct and fraud prevention programs).
 - The consistency of policies and procedures across the group, including a group financial reporting procedures manual.

The Group’s Risk Assessment Process

62. The group auditor’s understanding of the group’s risk assessment process may include matters such as group management’s risk assessment process, that is, the process for identifying, analysing and managing business risks, including the risk of fraud, that may result in material misstatement of the group financial report. It may also include an understanding of how sophisticated the group’s risk assessment process is and the involvement of entities and business units in this process.

The Group’s Process to Monitor the System of Internal Control

63. The group auditor’s understanding of the group’s process to monitor the system of internal control may include matters such as monitoring of controls, including how the controls are monitored across the group and, when relevant, activities of the internal audit function across the group, including its nature, responsibilities and activities in respect of monitoring of controls at entities or business units in the group. ASA 610⁹⁸ requires the auditor to evaluate the extent to which the internal audit function’s organisational status and relevant policies and procedures support the objectivity of internal auditors, the level of competence of the internal audit function, and whether the internal audit function applies a systematic and disciplined approach, including quality control.

⁹⁷ See ASA 315, Appendix 3.

⁹⁸ See ASA 610 *Using the Work of Internal Auditors*, paragraph 15.

The Information System and Communication

64. The group auditor's understanding of the group's information system and communication may include matters such as the following:
- The extent of centralisation in the group's IT environment and the commonality of IT applications, IT processes and IT infrastructure.
 - Group management's monitoring of operations and the financial results of entities or business units in the group, including regular reporting routines, which enables group management to monitor performance against budgets, and to take appropriate action.
 - Monitoring, controlling, reconciling, and eliminating intra-group transactions and unrealised profits, and intra-group account balances at group level.
 - A process for monitoring the timeliness and evaluating the accuracy and completeness of financial information received from entities or business units in the group.

Consolidation Process

65. The group auditor's understanding of the consolidation process may include matters such as the following:

Matters Relating to the Applicable Financial Reporting Framework

- The extent to which management of entities or business units in the group have an understanding of the applicable financial reporting framework.
- The process for identifying and accounting for entities or business units in the group 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 report, 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 entities or business units in the group with financial year-ends different from the group's year-end.

Matters Relating to the Consolidation Process

- Group management's process for obtaining an understanding of the accounting policies used by entities or business units in the group, and, when applicable, ensuring that uniform accounting policies are used to prepare the financial information of the entities or business units in the group for the group financial report, 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 entities or business units in the group 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 entities or business units in the group for the consolidation.

Auditing Standard ASA 600

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

- The process for translating the financial information of foreign entities or business units in the group into the currency of the group financial report.
- How the group's IT environment is organised for the consolidation and the policies that define the flows of information in the consolidation process, including the IT applications involved.
- Group management's process for obtaining information on subsequent events.

Matters Relating to Consolidation Adjustments and Reclassifications:

- The process for recording consolidation adjustments, including the preparation, authorisation 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.
- The business rationale for the events and transactions that gave rise to the consolidation adjustments.
- Frequency, nature and size of transactions between entities or business units in the group.
- The procedures for monitoring, controlling, reconciling and eliminating intra-group transactions and unrealised profits, and intra-group account balances.
- Steps taken to arrive at the fair value of acquired assets and liabilities, procedures for amortising goodwill (when applicable), and impairment testing of goodwill, in accordance with the applicable financial reporting framework.
- Arrangements with a majority owner or minority interests regarding losses incurred by an entity or business unit in the group (e.g., an obligation of the minority interest to make good such losses).

Control Activities

66. The group auditor's understanding of the control activities component may include matters such as the following:
- The commonality of information processing controls and general IT controls for all or part of the group.
 - The extent of the commonality of the design of controls for all or part of the group that address risks of material misstatement of the group financial report at the assertion level.
 - The extent to which commonly designed controls have been implemented consistently for all or part of the group.

Appendix 3

(Ref: Para. A110)

Examples of Events or Conditions that May Give Rise to Risks of Material Misstatement of the Group Financial Report

The following are examples of events (including transactions) and conditions that may indicate the existence of risks of material misstatement of the group financial report, whether due to fraud or error, including with respect to the consolidation process. The examples provided by inherent risk factor cover a broad range of events and conditions; however, not all events and conditions are relevant to every group audit engagement and the list of examples is not exhaustive. The events and conditions have been categorised by the inherent risk factor that may have the greatest effect in the circumstances. Importantly, due to the interrelationships among inherent risk factors, the example events and conditions also are likely to be subject to, or affected by, other inherent risk factors to varying degree. Also see ASA 315, Appendix 2.

Inherent Risk Factor	Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Report at the Assertion Level:
Complexity	<ul style="list-style-type: none"> • The existence of complex transactions that are accounted for in more than one entity or business units in the group. • The application of accounting policies by entities or business units in the group that differ from those applied to the group financial report. • Accounting measurements or disclosures that involve complex processes used by entities or business units in the group, such as accounting for complex financial instruments. • Operations that are subject to a high degree of complex regulation in multiple jurisdictions, or entities or business units in the group that operate in multiple industries that are subject to different types of regulation.
Subjectivity	<ul style="list-style-type: none"> • Judgements regarding which entities or business units in the group require incorporation of their financial information in the group financial report in accordance with the applicable financial reporting framework, for example, whether any special-purpose entities or non-trading entities exist and require incorporation. • Judgements regarding the correct application of the requirements of the applicable financial reporting framework by entities or business units in the group.
Change	<ul style="list-style-type: none"> • Frequent acquisitions, disposals or reorganisations.
Uncertainty	<ul style="list-style-type: none"> • Entities or business units in the group operating in foreign jurisdictions that may be exposed to factors such as unexpected government intervention in areas such as trade and fiscal policy, and restrictions on currency and dividend movements; and fluctuations in exchange rates.
Susceptibility to Misstatement Due to	<ul style="list-style-type: none"> • Unusual related party relationships and transactions.

Auditing Standard ASA 600***Special Considerations—Audits of a Group Financial Report (Including the Work of Component Auditors)***

Inherent Risk Factor	Examples of Events or Conditions that May Give Rise to the Existence of Risks of Material Misstatement of the Group Financial Report at the Assertion Level:
Management Bias or Other Fraud Risk Factors Insofar as They Affect Inherent Risk	<ul style="list-style-type: none">• Entities or business units in the group with different financial year-ends, which may be utilised to manipulate the timing of transactions.• Prior occurrences of unauthorised or incomplete consolidation adjustments.• Aggressive tax planning within the group, or large cash transactions with entities in tax havens.• Prior occurrences of intra-group account balances that did not balance or reconcile on consolidation.• Large or unusual cash transfers within the group, particularly to newly incorporated entities or business units operating in locations with a significant or heightened fraud risk

Indicators that the control environment, the group's risk assessment process or the group's process to monitor the group's system of internal control are not appropriate to the group's circumstances, considering the nature and complexity of the group, and do not provide an appropriate foundation for the other components of the group's system of internal control, include:

- Poor corporate governance structures, including decision making processes that are not transparent.
- Non-existent or ineffective controls over the group's financial reporting process, including inadequate group management information on monitoring of operations and financial results of entities or business units in the group.