

Question – I am performing an audit of a consolidation of a group what do I need to do to structure an audit file?

Question – I am performing an audit of a consolidation of a dormant holding company and its subsidiaries what do I need to do?

There is no set format for the preparation of a consolidated audit file structure, however the two most common file structures are explained as part of this query. Throughout this response it is assumed that the subsidiaries of the group are also audited as the parent company is only a holding company with no activity and the total size of the subsidiaries and group exceed the group audit exempt thresholds. In addition, it is assumed the appointed auditor and firm to the parent company are also the auditors to the subsidiaries.

For each subsidiary there is a separate individual fully documented audit file, as each subsidiary has separate financial statements which contain their own Auditors Reports.

The group financial statements contains an auditors report which encompasses an opinion on the consolidated primary statements and the parent holding company primary statements as well as accounting policies and notes for both parent and group. As the auditors report provides an opinion on both group and parent, the consolidation process must be audited and documented accordingly as well as the parent itself.

Option 1

The first way a consolidated file is prepared (which in fact is the most common way) is where one single file is prepared encompassing both the parent and the consolidation process of the entire group. How is this done:

1. A single planning section is prepared which documents both the parent and the group.
 - a. One planning memo is prepared that documents under each area, the considerations for the parent and then is followed by the Group considerations. (i.e. Knowledge of the entity should detail the parent and then group as a whole) (Ethical considerations should be done for the parent only and then followed by the Group as a whole) Risk assessments should be done for the parent on its own and then followed by the group as a whole (including consolidation risk aspects for the presentation of numbers in the Financial statements and eliminations).
 - b. Materiality should have three types of materiality documented and set.
 - i. A materiality level for the parent based on the numbers as presented in the primary statements of the parent entity and then,
 - ii. A Group materiality level for Overall, performance and Trivial is set for the consolidated numbers presented. This is separate again to those numbers set within the parent entity or those in the subsidiary audit files.
 - iii. A Component Materiality is the materiality for a component entity of the group which is determined by the group engagement team. While this is more relevant where there is different auditors for the parent and subsidiaries (i.e. Group and network audit firms). Nonetheless where the auditor is the auditor of the group and its subsidiaries, the auditor must ensure that the component materiality shall be lower than the Group Materiality set as a whole.

How might a Group audit materiality level be set? There are several methods to this, but one method might be to: generate the consolidated P&L and Balance sheet having eliminated intercompany balances and transactions and then apply % rates for Turnover, PBT, Gross Assets and Net Assets (as appropriate) to derive an overall group materiality level which is based on overall group numbers. **Note:** Testing or work done in the subsidiaries and the parent audit files based on their own audit materiality levels set may need to be extended based on the Group audit Materiality Thresholds set, as explained.

When can Group audit materiality be an amount lower than that set in the subsidiary? If the subsidiaries have significant intercompany/related party transactions taking place that the P&L or the Balance Sheet could be significantly inflated (i.e. High Turnover and Debtors) then when these intercompany transactions and balances are eliminated on consolidation that the overall group Turnover and Assets are significantly smaller than the main principle subsidiaries, attentively there may be goodwill that is eliminated on consolidation.

In these situations then the materiality level set at a group level could be lower than that which was set at the subsidiary level, accordingly it might then be the case that items which were scoped out as not being material for the subsidiary audit will now require audit work to be done on them for the Group audit file as they are below the group materiality threshold set..

Note: At the planning process for the group and subsidiaries, when it has been determined that consolidation is required. When documenting materiality for the each subsidiary, the parent and the group as a whole, if the group materiality is lower than that of the subsidiary materiality level, ensure the materiality level of the subsidiary is lowered to an amount lower than the group level set. This is to ensure work done in the subsidiary is sufficient for group reporting purposes, to reduce work load and ensure items are tested appropriately to match group and subsidiary reporting purposes.

- c. The engagement budget for work to be done might be only one budget which encompass the audit of both the group and parent
 - d. Any planning communications with team members or those in governance should document the audit process in its entirety and therefore detail the parent audit and then the consolidation audit process.
 - e. A single Letter of engagement covering both the group and the parent engagement and financial statements can be issued (this may also incorporate the audits for the subsidiaries as well).
2. Audit Execution – for each section of the file,
- a. A lead schedule for the parent should be included and then followed by a group consolidated lead schedule with an overall auditors conclusions on the section covering both parent and group.
 - b. If there are any items requiring testing in the parent these should be detailed and the testing documented.
 - i. All relevant sections that represent areas and numbers as presented in the primary statements, these might be Investment in subsidiaries, creditors/debtors for intercompany amounts, reserves and share

capital, in addition tax sections should still be documented and reviewed to ensure group reliefs or group tax implications have no impact to the dormant company tax computation.

- ii. As this is a holding company, the investment in subsidiaries section should be fully documented including consideration of the value of the cost / carrying amount of the investment in the subsidiaries, if there is an impairment trigger and it requires impairment below the current carrying value.
 - c. As each subsidiary has its own separate audit file, the group audit file can leverage off of work done in the subsidiaries file for each area and cross refer to each individual subsidiary and the relevant working papers of their relevant sections for testing work done. However as detailed in Option 1 b(v) above if group materiality is lower than the materiality levels set in a subsidiary that items not previously tested fall within scope for testing then this should be documented accordingly. **Note:** As part of each section of the group file consideration for the consolidation process and eliminations should be documented. In some cases
 - i. a whole section of the file details the consolidation process, detailing a table of each subsidiaries total numbers side by side, the parent and then details of the eliminations that are relevant in a separate column with a final total consolidation column that displays the numbers as per each lead schedule and the consolidated financial statements. As part of the file, each elimination journal is broken down, explained and tested. The auditors documentation in accordance with ISA 230 details the objective, the work done and an overall auditors conclusion. Where relevant Audit Evidence (ISA 500) is attached to the file to support the journals ((i.e. a nominal listing of intercompany sales by one company and the corresponding purchases listing received by the related company) or (if a foreign subsidiary documentation supporting the testing of the fx rates used for the consolidation and recording of transactions during the year)).
 - ii. Another way the consolidation process is documented in files, is that in each section of the file, to support the consolidated lead schedule presented, the testing of the consolidation process specific to that area is documented, rather than being done as a standalone section (as detailed above). Documentation and testing of the consolidation process continues to be the same as detailed above.
3. Audit Completion – this is documented in the same manner as planning.
- a. A letter of representation should be signed encompassing both the parent entity and the group. (as a best practice a listing of the consolidation journal adjustments that have been made which encompass the eliminated intercompany transactions and balances should be signed off as agreed by the directors and those charged with governance).
 - b. As there are separate materiality levels for both group and parent, there may be separate summaries of unadjusted differences to be considered and presented to management.
 - c. Analytical reviews should be performed for the parent entity and separately the group as a whole, with clear documentation demonstrating an understanding of what the principle movements are in relation to having gained the knowledge from the work done in the audit of the parent, its subsidiaries and the group as a whole.

- d. Subsequent events should be documented for the parent entity and also the group as a whole.
- e. Going Concern ISA 570 discusses the entity specifically as part of its objective. In this case; it is the parent, however the parent being dormant will be intrinsically linked to the subsidiaries continuation, therefore the file should detail the parent and the subsidiaries consideration of;
 - i. their ability to continue
 - ii. their impact on the parent and group; or
 - iii. if appropriate their actual inability to continue.

Then from the overall assessment you conclude on the parent and the group's ability to continue as a going concern as that is basis on which the financial statements are prepared.

- f. In forming the auditors' opinion and considering its form and structure the auditor should document its considerations of their conclusions formed for the various sections of the parent and then consider their conclusions formed on each section of the consolidation process, as the report is covering both the parent and the group presented financial statements therefore consideration of both must be documented.

Option 2

The second option in presenting structured audit file is the auditor can prepare:

1. A standalone Dormant Company audit file as the entity is only a holding company.
 - a. This encompasses a full planning section including materiality levels specific and relevant for the parent.
 - b. Audit Execution sections
 - i. should contain lead schedules and working papers for all relevant sections that represent areas and numbers as presented in the primary statements, these might be Investment in subsidiaries, creditors/debtors for intercompany amounts, reserves and share capital, in addition tax sections should still be documented and reviewed to ensure group reliefs or group tax implications have no impact to the dormant company tax computation.
 - ii. As this is a holding company, the investment in subsidiaries section should be fully documented including consideration if the value of the cost of investment in the subsidiaries requires impairment below their current carrying value or if there is an impairment trigger.
 - c. The Completion sections, should be completed from a high level as to whether there were any issues in the parent that might affect the auditors opinion formed, however the more detailed considerations could be done as part of the overall group conclusion and audit opinion formed.
2. For the group –
 - a. A single Letter of engagement covering both the group and the parent engagement and financial statements can be issued.
 - b. Planning needs to be documented from the overall group and consolidation basis,
 - i. detail the structure of the group,
 - ii. its ownership, its principle subsidiaries and the management structure of the group and particularly those that control, run and make decisions on behalf of the group

- iii. The principle audit risks to the group as a whole (including consolidation risk aspects for the presentation of numbers in the Financial statements and eliminations)
- iv. Ethical considerations should be looked at in the context of the group as a whole, i.e. Total fee's for the group for audit and non-audit services and what services are provided to all subsidiaries of the group etc.
 - i. Set a Group materiality level for Overall, performance and Trivial. (see option 1 - 1b(v) for group materiality considerations)
- c. As each subsidiary and the parent company have separate audit files the group audit file can leverage off of work done in the subsidiaries files for each area and cross refer to each individual subsidiary and parent file and their relevant sections for testing work done. At a minimum the consolidation file for each execution area should have a Lead Schedule, with an overall auditor's conclusion for that section. However as detailed in 1b(v) if group materiality is lower than the materiality levels set in a subsidiary that items not previously tested fall within scope for testing then this should be documented accordingly.

Note: As part of each section of the group file consideration for the consolidation process and eliminations should be documented. In some cases

- i. a whole section of the file details the consolidation process, detailing a table for the parent and the subsidiaries total numbers side by side, and a column detailing the eliminations that are relevant to the final total consolidation column which displays the numbers as per each lead schedule and the consolidated financial statements. As part of the file, each elimination journal is broken down, explained and tested. The auditors documentation in accordance with ISA 230 details the objective, the work done and an overall auditors conclusion. Where relevant audit evidence (ISA 500) is attached to the file to support the journals ((i.e. a nominal listing of intercompany sales by one company and the corresponding purchases listing received by the related company) or (if a foreign subsidiary documentation supporting the testing of the fx rates used for the consolidation and recording of transactions during the year)).
- ii. Another way the consolidation process is documented in files, is that in each section of the file, to support the consolidated lead schedule presented in that section. The testing of the consolidation process specific to that area is documented, rather than being done as a standalone section (as detailed above). Documentation and testing of the consolidation process continues to be the same as detailed above.

The Completion section of the consolidated audit file continues to the same as a standard audit. However as certain considerations are specific to the parent entity work required may be reduced accordingly. (i.e. Going Concern, under ISA 570's objective details the entities ability. In this case that is the parent, however the parent being dormant will be intrinsically linked to the subsidiaries continuation, therefore the parent file should detail the parent and the subsidiaries consideration and accordingly the group file can then cross refer to the parent file). Subsequent events should be assessed from the group as a whole. A detailed completion Analytical review for the group audit should be performed demonstrated understanding of what the principle movements are in relation to having gained the knowledge from the work done in the audit of the parent, its subsidiaries and the group as a whole. As part of the completion process detailed documentation having considered each section of the

consolidation process and your conclusions formed the impact on the form and structure of your auditors opinion particularly in the context of the consolidation but that the opinion is part of the overall opinion of the group and parent financial statements and cross refer to the parent file where the parent specific considerations are made.

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