

**STATEMENT 3.280**  
**AUDITING GUIDELINE**  
**GROUP FINANCIAL STATEMENTS — RELIANCE ON THE**  
**WORK OF OTHER AUDITORS**

**Introduction**

1. This guideline is intended to clarify the duties, responsibilities and practices of the auditor when reporting on group financial statements that include amounts derived from the financial statements of subsidiaries or of associated companies which have been audited by other auditors. It should be of use to auditors who act as either primary or secondary auditors.
2. For the purposes of this guideline, the term "primary auditor" refers to an auditor who is responsible for the audit opinion on group financial statements. A "secondary auditor" is an auditor of a subsidiary or associated company who is not the primary auditor and is responsible for his own audit opinion on the secondary company's financial statements. All other definitions of terms used in the guideline are included in the Appendix.
3. The relationship between primary and secondary auditors is not the same as that between the auditors involved:
  - (a) in a joint audit; or
  - (b) where a company has operations based at several locations or branches and local auditors, acting as agents, work on behalf of the primary auditor.

Accordingly, neither of these situations is covered by this guideline.

4. This guideline is written in the context of companies and company legislation, which imposes on the directors of a holding company the responsibility to prepare group financial statements which give a true and fair view so far as concerns the members of the holding company. The auditor of any other form of entity is guided by the terms of his particular appointment and by the relevant legislation, but, in the absence of specific provisions to the contrary, the general principles embodied in this guideline should be followed.
5. The primary auditor is required to express an opinion on the group financial statements and has sole responsibility for this opinion even where those group financial statements include amounts derived from accounts which have not been audited by him. As a result, he cannot discharge his responsibility to report on the group financial statements by an uninformed acceptance of secondary companies' financial statements, whether audited or not.

6. As explained below, however, the primary auditor can take account of the extent of work and the report of other (secondary) auditors through carrying out certain procedures. The extent of these procedures will be determined by the materiality of the amounts derived from the financial statements of secondary companies and the level of risk that the auditor is willing to accept that such statements contain material errors.

#### **The relationship between the primary and the secondary auditor**

7. The relationship between a primary and a secondary auditor is not that between a principal and an agent. If, however, the secondary company is a subsidiary, and both the primary company and the secondary company are incorporated in Hong Kong, the secondary company and its auditor have a statutory duty under S133(1)(a) of the Companies Ordinance to give to the primary auditor such information and explanations as that auditor may reasonably require for the purposes of his duties as auditor of the primary company.
8. Where the statutory duty described in the previous paragraph does not exist, the primary company has a statutory duty under S133(1)(b) of the Companies Ordinance to take all steps reasonably open to it to obtain from the subsidiary such information and explanations as the primary auditor may reasonably require for the purposes of his duties as auditor of the primary company.
9. Even where his responsibilities in this regard are not set down by statute, the secondary auditor should appreciate that the secondary company's financial statements will ultimately form a part of the group financial statements. In principle, the secondary auditor should therefore be prepared to co-operate with the primary auditor and make available such information as the primary auditor may require in order to discharge his duties as auditor of the group financial statements.
10. The primary auditor should as a matter of courtesy inform the directors of the primary company of his intention to communicate with the secondary auditor. The nature of the instructions which are to be given to the secondary auditor, and the information required from him, should be discussed by the primary auditor with the directors of the primary company at the planning stage. Where the primary auditor has no statutory right to approach the secondary auditor, he should arrange for the secondary auditor to be instructed to co-operate by the directors of the secondary company, in order to ensure that the duty of confidentiality owed by the secondary auditor to his client is maintained. This may not be possible where the secondary company is an associated company, as the directors of the primary company may have less control than in the case of a subsidiary company.

11. The primary auditor should inform the secondary auditor in advance of the standard and scope of work required and any reporting deadlines that are to be met. For effective co-operation to take place, the primary and secondary auditors should communicate with each other as early as possible in the planning stage of the audit. The secondary auditor should discuss problems that may lead to delay in reporting or to qualification of his opinion as soon as they arise.

### **Operational procedures**

#### **Materiality**

12. In deciding what audit procedures are necessary, the primary auditor should consider the audit risk involved and the materiality of the amounts in the context of the group financial statements. This will involve an evaluation of the significance of each secondary company and also of each account area or item of disclosure, as it is possible that a particular area (e.g. stock or fixed assets) will be considered material in the context of the group as a whole.
13. A secondary company which is not itself material in the context of the group financial statements may, when taken together with other non-material secondary companies, result in a combination which is material. When this occurs, the primary auditor should proceed as if those secondary companies were material when considered individually.
14. Any decisions taken regarding materiality should be reassessed each year.

#### **General procedures**

15. The scope and nature of the primary auditor's procedures will vary depending on the particular circumstances of each case. Judgements will need to be made in the light of factors such as the scope of work of the secondary auditor, specific audit problems encountered in the past, and the likely degree of change in the secondary company's results and state of affairs. At the planning stage the primary auditor should assess the risk inherent in the assignment and the related likelihood of audit problems. The information relevant to this preliminary assessment will include the financial statements for earlier periods for both the group and the secondary company.

16. The primary auditor should obtain and read the financial statements of the secondary company for the period under consideration at the earliest opportunity. This, when taken in conjunction with other information which the primary auditor has, may enable him to determine that the secondary company is immaterial in the context of the group financial statements. In all other cases the primary auditor should then, as a minimum, consider and be satisfied about the general scope of the work of the secondary auditor and in particular:
  - (a) the terms of the secondary auditor's engagement and any limitation placed on his work;
  - (b) the standard of work of the secondary auditor and the nature and extent of his audit examination;
  - (c) any differences between the auditing, accounting and other professional standards governing the secondary auditor's work and those applicable in Hong Kong, and any steps taken by the secondary auditor to conform to Hong Kong standards; and
  - (d) the independence of the secondary auditor.
17. These matters may be dealt with by means of a questionnaire. The completed questionnaire should be reviewed by the primary auditor, who should evaluate the reasonableness of the information provided in the light of his knowledge of the business, and follow up any matters which require further explanation.
18. Frequently the secondary company will be of such significance that the primary auditor will supplement the above procedures by a review of the secondary auditor's working papers.
19. The principal objective of such a review is to ensure that it is reasonable for the primary auditor to rely on the work of the secondary auditor when expressing an opinion on the group financial statements. He is not expressing his own opinion on the financial statements of the secondary company, and he is not required to re-perform the secondary auditor's work or re-evaluate the audit evidence examined by the secondary auditor. The primary auditor should instead satisfy himself that the audit has been carried out in accordance with approved Auditing Standards and that the conclusions reached by the secondary auditor are both reasonable and reliable.

20. In the circumstances described in paragraph 13, the review of the secondary auditors' working papers may be carried out on a periodic basis.
21. In addition, any qualification in the secondary auditor's report should be considered by the primary auditor to ascertain whether it affects his report on the group financial statements.

### **Additional procedures**

22. If as a result of the above procedures the primary auditor is not satisfied for the purpose of reporting on the group financial statements, he should discuss the problem with his client. If necessary, he should arrange for the secondary auditor to conduct additional audit tests (either alone or jointly with the primary auditor). In exceptional circumstances only, the primary auditor may need to conduct his own tests independently of the secondary auditor. The secondary auditor is fully responsible for the standard of his own work and for his report on the secondary company's financial statements. Therefore any additional tests are those required solely for the audit of the group financial statements.

### **Further considerations**

#### **Availability of information**

23. Primary company directors need to secure sufficient information to satisfy themselves that the group financial statements give a true and fair view, and disclose all the information required by statute and other appropriate regulations. Problems due to the lack of necessary information are likely to arise in two specific situations: where the primary and secondary companies are incorporated in different countries, and are not subject to the same legislation, or where secondary companies' year ends differ from that of the primary company.
24. If the primary auditor finds that the directors of the primary company lack information about the accounting policies, items for disclosure, or consolidation adjustments relating to the financial statements of secondary companies, he should ask for the omission to be made good. Occasionally it may be necessary for the primary auditor, after obtaining permission, to obtain the additional information directly from the secondary companies concerned or from their auditors. The primary auditor may need to arrange for such additional information to be audited by the secondary auditor.

### **Accounting policies**

25. The primary auditor should discuss with the primary company's directors, or other responsible officials, the accounting policies in force throughout the group in order to ensure that these are, in his opinion, appropriate to and consistent with the proper preparation of the group financial statements.
26. Consistent accounting policies will normally be adopted throughout the group. However, in certain exceptional cases this may not be possible because financial statements of secondary companies are the responsibility of their directors who will have to consider the interests of minority shareholders and comply with local legislation or practice. Where the use of differing accounting policies results in adjustments being necessary to arrive at consolidated figures, the primary auditor should both ensure that the primary company's directors have obtained all the information necessary to make these adjustments, and satisfy himself that any adjustments are appropriate.
27. Where adjustments are impracticable and material figures based on different accounting policies are included in the group financial statements, the primary auditor should ensure that the policies adopted are fully explained and, where possible, the effects of the different policies are quantified.

### **Reporting**

28. Where there are material subsidiary or associated companies not audited by the primary auditor, the primary company may find it helpful to indicate this in the notes to the group financial statements. However, whether or not this information is given, the primary auditor should not ordinarily refer in his report to the name of any secondary auditor, or to the fact that secondary companies have been audited by other auditors. This is because the primary auditor cannot delegate the responsibility for his opinion and any such reference might mislead the reader into believing otherwise.
29. In the event of any restriction in the scope of his audit of the group financial statements the primary auditor should consider qualifying his report.

**Appendix****DEFINITION OF TERMS**

- Associated company: a company as defined by SSAP10, paragraph 8.
- Holding company : a company having interests in one or more subsidiary companies as defined by the Companies Ordinance.
- Primary company : a company which is required to produce group (normally consolidated) financial statements which may incorporate amounts taken from the financial statements of subsidiary or associated companies.
- Secondary company : a subsidiary or associated company which is audited by a secondary auditor.
- Subsidiary company : a company as defined by the Companies Ordinance.