INSTITUTE OF SINGAPORE CHARTERED ACCOUNTANTS

5 April 2024

ISCA Audit Bulletin 4

AB 4:
Non-Consolidation of Subsidiaries – Considerations for the Auditor's Report

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1. Background

FRS 110 / SFRS(I) 10 *Consolidated Financial Statements* requires an entity (the parent) that controls one or more other entities (the subsidiaries) to present consolidated financial statements, unless it meets the exemption criteria for non-consolidation under paragraph 4(a).

There may be instances where the requirements of FRS 110 / SFRS (I) 10 are not met, such as where:

(i) the parent only presents non-consolidated financial statements (i.e. separate financial statements of the parent) even though it does not meet the exemption criteria; or

(ii) the parent fails to consolidate one or more subsidiaries in its consolidated financial statements.

In such situations, the auditor should first encourage management to "do the right thing" to comply with the financial reporting standards, failing which the auditor would need to assess whether the audit opinion on the financial statements needs to be modified.

2. Scope of this Audit Bulletin

This Audit Bulletin (AB) highlights key considerations for the auditor when assessing the effects of non-consolidation of subsidiaries on the auditor's report, including the types of audit opinions that may be issued.

3. Key Considerations in Assessing Effects of Non-Consolidation

The key considerations in assessing the effects of non-consolidation on the audit opinion are whether the financial statements are materially misstated as a result of the non-consolidation and whether the effects of the non-consolidation are pervasive to the financial statements. Under the scenario where consolidated financial statements are not prepared i.e. only separate financial statements of the parent are presented, the auditor considers the effects of non-consolidation with reference to the separate financial statements. It is important for the auditor to exercise professional judgement in evaluating the facts and circumstances on a case-by-case basis in arriving at the conclusions on which the audit opinion is based.

The auditor should evaluate the reliability of the financial information of the unconsolidated subsidiaries when using such information to assess materiality and pervasiveness.

3.1 Is the misstatement material?

In the context of an audit, misstatements, including omissions, are considered to be material if they, **individually or in the aggregate, could reasonably be expected to influence the economic decisions of users** taken on the basis of the financial statements. Judgments about materiality are made in light of surrounding circumstances and are **affected by the size or nature of a misstatement, or a combination of both**.

Quantitative considerations

The auditor should evaluate the impact of the non-consolidated subsidiary(ies) on the relevant classes of transactions, account balances or disclosures at the consolidated level, including whether the materiality level for that particular class of transactions, account balance or disclosure at the consolidated level, if any, has been exceeded.

Qualitative considerations

While certain misstatements may be lower than the materiality determined for the audit (from a quantitative perspective), the auditor may determine that such misstatements, due to their qualitative nature, could have a material effect on the financial statements.

Certain qualitative disclosures may be important to users of the consolidated financial statements because of their nature. For example, disclosures on risk exposure arising from non-compliance with laws and regulations of a non-consolidated subsidiary may be viewed as material, even if that subsidiary is not quantitatively material to the consolidated financial statements.

3.2 Is the misstatement pervasive?

In accordance with SSA 705 (Revised)[1], pervasive effects on the financial statements are those that:

- Are not confined to specific elements, accounts or items of the financial statements;
- Even if so confined, represent or could represent a substantial portion of the financial statements; or
- In relation to disclosures, are fundamental to users' understanding of the financial statements.

Essentially, if the auditor believes that users cannot substantially rely on the financial statements for decision-making, then the effect of the misstatements is pervasive.

When assessing whether misstatements arising from non-consolidation could be pervasive, the auditor may consider:

- The number of classes of transactions, account balances or disclosures at the consolidated level that are affected by the non-consolidation;
- Whether the non-consolidated amounts make up a substantial portion of the individual consolidated financial statement line items.

3.3 Re-assessment of risks of material misstatement

The auditor should seek to understand the reason for the non-consolidation and assess if there are additional risks of material misstatement that have not been identified arising from such non-consolidation. These could include:

- **Assessing the risk of other unconsolidated subsidiaries.** If the non-consolidation arose due to deficiencies in controls in the financial statements closing process, there could be a risk of other non-consolidated entities, particularly if there are systemic control issues in the financial reporting process. For example, if the reason for the non-consolidation is due to an inexperienced group finance team that is unable to effectively manage their subsidiaries' reporting, the non-consolidation might not be limited to one subsidiary. In this case, the auditor would have to perform additional audit procedures to address the completeness of the consolidated entities and evaluate the reliability of the financial information of the unconsolidated subsidiaries

[1] SSA 705 (Revised) *Modifications to the Opinion in the Independent Auditor's Report*.

when using such information to assess materiality and pervasiveness. When determining the extent of such additional procedures, the auditors may consider factors such as the complexity of the group structure, the extent to which financial reporting activities are decentralised across individual subsidiaries and where operations span across multiple jurisdictions.

- **Assessing the risk of further undetected misstatements**. If the aggregate of the non-consolidated amounts is close to materiality, there could be an unacceptably high risk that the financial statements are materially misstated, taking into account that there could be further undetected misstatements.

  The auditor should understand the reason why the misstatements occurred (in this case, why the subsidiaries were not consolidated). If the reason for not consolidating a subsidiary is due to poor performance or poor financial position of the subsidiary, there may be a heightened risk of material misstatement. For example, if management chooses not to consolidate a subsidiary due to a material loan amount which they do not want to be reflected in the consolidated financial statements, the auditor would need to consider if this indicates a heightened risk of intentional omission of other loan amounts and adjust the nature, timing and extent of audit procedures to address the risks of material misstatement.

- **Assessing the integrity of management**. Arising from the non-consolidation, the auditor should consider if this is indicative of any deficiencies in management's integrity and its impact on the overall audit.

4. Modifications to Opinion

The flowchart in page 8 illustrates the decision-making process that the auditor can follow when considering the type of opinion to be expressed. Professional judgement should be exercised by the auditor when forming the audit opinion. Public accountants are reminded to adhere to the requirements of SSA 705 (Revised), including the requirements on presentation and content, when issuing a modified opinion.

Implications on the opinion where the auditor is opining on the consolidated financial statements and company level statement of financial position[2]

In accordance with the Companies Act 1967 ("the Act"), other than opining on the consolidated financial statements of the group, the auditor is also required to opine on the statement of financial position of the parent company[3]. With reference to paragraph 15 of SSA 705 (Revised)[4], when an adverse opinion is expressed on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement. This means that when an adverse opinion is issued on the consolidated financial statements of the group, a modified opinion would need to be issued on the statement of financial position of the parent company within the same set of financial statements. This applies when a disclaimer of opinion is issued on the consolidated financial statements as well.

[2] This section does not apply to the scenario where the consolidated financial statements are not prepared and the auditor is opining only on the parent company financial statements. This section also does not apply to the scenario where the auditor is opining on the consolidated financial statements and a complete set of company level financial statements.
[3] S207(2)(a)(ii) of the Act.
[4] Paragraph 15 of SSA 705 (Revised) states that when the auditor considers it necessary to express an adverse opinion or disclaim an opinion on the financial statements as a whole, the auditor's report shall not also include an unmodified opinion with respect to the same financial reporting framework on a single financial statement or one or more specific elements, accounts or items of a financial statement. To include such an unmodified opinion in the same report in these circumstances would contradict the auditor's adverse opinion or disclaimer of opinion on the financial statements as a whole.

A concern arising from this is that the modified opinion would not accurately reflect the state of affairs of the parent company on a standalone basis. To address this, the description of the reason for the modification should be clearly stated so that users are aware that the modification did not arise from the financials of the parent company.
Below is an example of how such an opinion may be worded:

Adverse Opinion

We have audited the financial statements of ABC Company (the Company) and its subsidiaries (the Group), which comprise the consolidated statement of financial position of the Group and the statement of financial position of the Company as at 31 December 20X1, and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows of the Group for the year then ended, and notes to the financial statements, including material accounting policy information.

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements of the Group and the statement of financial position of the Company do not give a true and fair view of the consolidated financial position of the Group and the financial position of the Company as at 31 December 20X1 and of the consolidated financial performance, consolidated changes in equity and consolidated cash flows of the Group for the year then ended in accordance with the provisions of the Companies Act 1967 (the Act) and Singapore Financial Reporting Standards (International) (SFRS(I)s).

Basis for Adverse Opinion

As explained in Note X, the Group has not consolidated subsidiary XYZ and the Group's investment in subsidiary XYZ has been accounted for on a cost basis in the consolidated statement of financial position. Under [FRS 110 / SFRS (I) 10 *Consolidated Financial Statements*], the Group is required to consolidate this subsidiary as part of the consolidated financial statements. Had XYZ been consolidated, multiple elements in the accompanying consolidated financial statements would have been materially affected. [State the effects on the consolidated financial statements arising from the non-consolidation of XYZ, or if it is not practicable to quantify the financial effects, to state so].

We conducted our audit in accordance with Singapore Standards on Auditing (SSAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Group in accordance with the Accounting and Corporate Regulatory Authority (ACRA) Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (ACRA Code) together with the ethical requirements that are relevant to our audit of the financial statements in Singapore, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ACRA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse opinion.

Communications with Those Charged with Governance

The auditor is reminded to communicate with those charged with governance on significant deficiencies in internal control that the auditor has identified and the circumstances that led to the expected modification and the wording of the modification. This is especially important if the auditor is aware of any unusual reason or suspects any unusual transactions that are recorded in the non-consolidated subsidiary.

5. Other Reporting Requirements

The auditor also needs to consider implications of the non-consolidation on other reporting requirements.

Implications on reporting on other legal and regulatory requirements[5]

If the non-consolidated subsidiary is incorporated in Singapore and the auditor is also acting as the auditor of that subsidiary, the auditor would still need to assess and evaluate if its accounting and other records have been properly kept for the purpose of reporting on other legal and regulatory requirements.

The auditor would need to consider the implications of the non-consolidation on the opinion expressed on the accounting and other records.

Implications on reporting on other information

When the auditor expresses a qualified or an adverse opinion, the auditor is reminded to consider the implications of the matter giving rise to the modification of opinion on the reporting on other information, in accordance with SSA 720 (Revised)[6].

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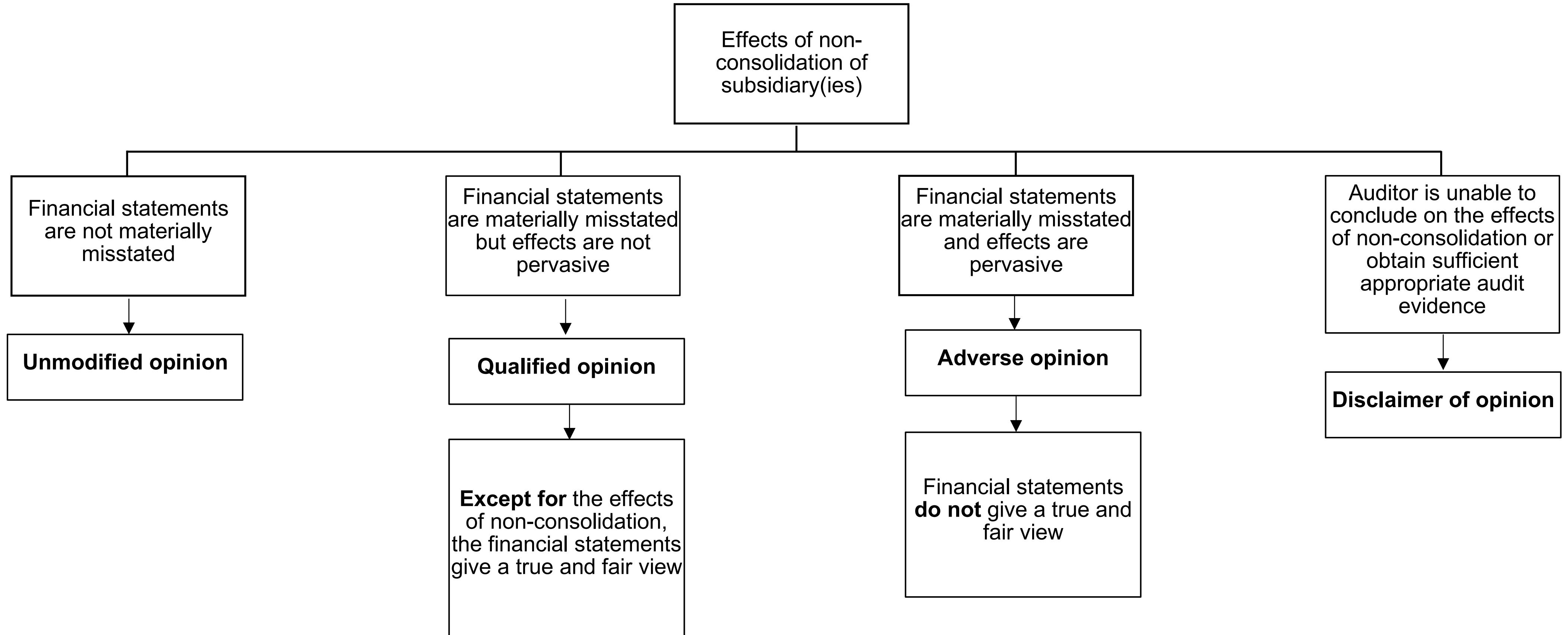
[5] Relevant regulatory requirements under the Act include:

- Section 199(1) requires the Company to keep proper accounting and other records, to sufficiently explain the transactions and financial position of the Company; to enable true and fair financial statements and any documents required to be attached thereto to be prepared from time to time; and to enable those records to be conveniently and properly audited.
- Section 207(2)(b) requires the auditor to report on whether the accounting and other records required by the Act to be kept by the company and, if it is a parent company, by the subsidiary corporations other than those of which the auditor has not acted as auditor have been, in the auditor's opinion, properly kept in accordance with the Act.
- Section 207(3)(b) requires the auditor to form an opinion on whether proper accounting and other records, excluding registers, required to be kept under section 199(1), have been kept by the company as required by the Act.
- Section 207(4) states that an auditor is not required to form an opinion in the auditor's report as to whether the accounting and other records of subsidiary corporations (which are not incorporated in Singapore) of a Singapore parent company have been kept in accordance with this Act.

[6] Refer to [Link] for further guidance on reporting on other information in the event of a qualified or adverse opinion.

Flowchart: Effects of Non-Consolidation of Subsidiary(ies) on the Audit Opinion



Appendix

Illustrative Examples

The illustrative examples cover general purpose statutory financial statements and the audit of these financial statements

- Illustration 1: Group consists of a parent company and one inactive subsidiary that is not consolidated.

- Illustration 2: Group consists of a parent company and one active subsidiary that is not consolidated.

- Illustration 3(a): Group consists of a parent company with multiple subsidiaries. A single asset holding subsidiary with no active operations is not consolidated.

- Illustration 3(b): Group consists of a parent company with multiple subsidiaries. One active subsidiary is not consolidated.

The examples provided in this audit bulletin are for illustrative purposes only. Auditors are reminded to exercise their professional judgement when evaluating the facts and circumstances of their engagements as well as the effect of the misstatements arising from the non-consolidation.

Auditors are also reminded to assess the implications of the non-consolidation on their reporting on other legal and regulatory requirements and other information (see Section 5. Other Reporting Requirements).

Illustration 1: Group consists of a parent company and one inactive subsidiary that is not consolidated.

For purposes of Illustration 1, the following circumstances are assumed:

- The group consists of a parent company and one inactive subsidiary.
- The subsidiary was incorporated solely to provide administrative and corporate services to the parent company for its business operations. However, the provision of such services had ceased in previous years. Nevertheless, the parent company decided to maintain the subsidiary.
- Consolidated financial statements have been not prepared (i.e. the parent company only prepares separate financial statements) since the subsidiary became inactive.
- Exemption criteria for non-consolidation under SFRS(I) 10 / FRS 110 is not met.

Two scenarios have been illustrated for the above circumstances.

Scenario 1

Based on the procedures performed and evidence obtained during the audit, the auditor is satisfied that there are no misstatements other than the non-compliance with the consolidation requirement in accordance with SFRS(I) 10 / FRS 110. As the auditor has concluded that the effects of non-consolidation are not material or pervasive, an unmodified opinion has been issued on the parent company's financial statements.

Scenario 2

In this scenario, the subsidiary has a contingent liability which warrants disclosure in accordance with SFRS (I) 1-37 / FRS 37[7] and the estimate of its financial effect, in the form of potential cash outflow, is material to the group but neither represents a substantial portion of the financial statements nor result in a material uncertainty relating to going concern.

From a presentation and disclosure perspective, the auditor assessed that the non-consolidation is material but not pervasive (as the effects are confined to liabilities and while material, does not represent a substantial portion of the financial statements. In this case, a qualified (except for) opinion has been issued on the parent company's financial statements.

[7] SFRS (I) 1-37 / FRS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Illustration 2: Group consists of a parent company and one active subsidiary that is not consolidated.

For purposes of Illustration 2, the following circumstances are assumed:

- The group consists of a parent company and one active subsidiary.
- The financial statements of the subsidiary represent a substantial portion of the financial statements, affecting multiple financial statement line items (FSLI).
- Consolidated financial statements have not been prepared (i.e. the parent company only prepares separate financial statements).
- Exemption criteria for non-consolidation under SFRS(I) 10 / FRS 110 is not met.

Because the subsidiary is financially significant to the group and the effects of the non-consolidation are not confined to specific elements, accounts or items of the financial statements, the auditor assessed that the effects of the non-consolidation are both material and pervasive. Consequently, an adverse opinion was issued on the parent company's financial statements.

Illustration 3(a): Group consists of a parent company with multiple subsidiaries. A single asset holding subsidiary with no active operations is not consolidated.

For purposes of Illustration 3(a), the following circumstances are assumed:

- The group consists of a parent company with multiple subsidiaries.
- Consolidated financial statements are prepared but one inactive subsidiary is not consolidated.
- While the unconsolidated subsidiary does not engage in active operations, it holds a property.

Three scenarios have been illustrated for the above circumstances.

Scenario 1

In this scenario, the value of the property is material to the group financial statements. However, the auditor assessed that the effect of non-consolidation is confined to the property, plant and equipment line item of the group financial statements (in the absence of other risks) and therefore not pervasive. Hence, a qualified (except for) opinion was issued on the group's financial statements.

Scenario 2

In this scenario, the property held by the unconsolidated subsidiary is a sanctioned asset, and the auditor assessed that the ownership of the property by the subsidiary has significant regulatory and legal ramifications to the group and the related disclosures are fundamental to the users' understanding of the financial statements. The auditor assessed that the effects of non-consolidation are material and pervasive, as the effects of such regulatory and legal ramifications would not be captured in the consolidated financial statements due to the non-consolidation[8]. As such, an adverse opinion was issued on the group's financial statements.

Scenario 3

Similar to Scenario 2, the property held by the unconsolidated subsidiary is a sanctioned asset. However, while there may be regulatory and legal ramifications to the group, the auditor is unable to obtain sufficient appropriate audit evidence on which to conclude whether the effects of the non-consolidation are material and pervasive, due to lack of clarity of the laws and regulations of the location in which the asset is held. As such, a disclaimer of opinion was issued on the group's financial statements.

[8] In some cases, even if the impact of a misstatement is confined to one FSLI, it may not necessarily mean that the effects of the misstatement are not pervasive. The auditor should also consider if there would be substantial changes to the risk profile of the group if the non-consolidated subsidiary had been consolidated.

Illustration 3(b): Group consists of a parent company with multiple subsidiaries. One active subsidiary is not consolidated.

For purposes of Illustration 3(b), the following circumstances are assumed:

- The group consists of a parent company with multiple subsidiaries.
- Consolidated financial statements are prepared but one active subsidiary is not consolidated.
- The unconsolidated subsidiary engages in active operations and holds multiple assets. It also has a receivable due to the parent company. The financial statements of the unconsolidated subsidiary represent a substantial portion of the group financial statements and affects multiple FSLI.

Two scenarios have been illustrated for the above circumstances.

Scenario 1

In this scenario, the subsidiary is financially significant to the group, and the effects of the non-consolidation are not confined to specific elements, accounts or items of the group financial statements. Also, the receivable due to the parent company is material to the group financial statements. Due to the non-consolidation, the receivable is not eliminated, resulting in an overstatement of the group receivables amount.

The auditor assessed that the effects of the non-consolidation are both material and pervasive. As such, an adverse opinion was issued on the group's financial statements.

Scenario 2

In this scenario, the auditor is informed by the management that the current year accounting records of the subsidiary are not available. However, the auditor was able to obtain management's forecast of the current year financial results, as well as the prior year's financial statements of the subsidiary.

Would this result in a disclaimer of opinion or an adverse opinion?

In deciding on the type of opinion to be issued, the auditor can consider whether the reason for the modification of the audit opinion is due to:

- Non-compliance with financial reporting standards; or
- Inability to obtain sufficient appropriate audit evidence on which to base the opinion (limitation on the scope of the audit).

In this scenario, management has not consolidated the subsidiary and hence the issue here is non-compliance with financial reporting standards. This is slightly different from a situation where management has consolidated the subsidiary, but the auditor is unable to obtain sufficient appropriate audit evidence on the accuracy of the financials of the subsidiary.

Having considered that the financial statements have not been prepared in accordance with the applicable financial reporting framework and given that the effects are material and

pervasive based on the forecasted current year financial results, an adverse opinion was issued on the group's financial statements.

If the auditor is unable to obtain sufficient appropriate audit evidence to conclude whether the effects of the non-consolidation are material, this would constitute a limitation of scope, resulting in a disclaimer of opinion being issued.

For reference: ISCA Auditing and Assurance Pronouncements and Publications

The table below summarises the formal categorisation, degrees of authority and due process for issuance of ISCA's auditing and assurance standards and guidances. This provides credence to ISCA's technical content, promulgates ISCA's views on the application of auditing and assurance standards as well as promotes best practices and consistency in auditing and assurance.

Category	Nature	Degree of authority	Due Process	Highest level of approval
1. a) Singapore Standard on Auditing (**SSA**) b) Singapore Standard on Assurance Engagements (**SSAE**) c) Singapore Standard on Review Engagements (**SSRE**) d) Singapore Standard on Related Services (**SSRS**) e) Singapore Standard on Quality Control (**SSQC**) f) Statement of Auditing Practice (**SAP**)	Authoritative pronouncements	Required to comply	Public consultation required	ACRA's Public Accountants Oversight Committee
2. a) Audit Guidance Statement (**AGS**) b) Singapore Auditing Practice Note (**SAPN**)	Provide interpretive and practical guidance to auditors Non-authoritative	Expected to apply or explain departures	Public consultation required	ISCA Council
3. Audit Bulletin (**AB**)	Informative / educational publications to highlight pertinent topical issues to auditors Non-authoritative	For information and educational purposes	Public consultation not required	ISCA AASC

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