Case 14-8
Tiger Pride Enterprises

You are the audit senior for Tiger Pride Enterprises (Tiger Pride). The audit partner has asked you to review the AICPA Statement on Auditing Standards (SAS) AU-C 600, *Special Considerations — Audits of Group Financial Statements (Including the Work of Component Auditors)* (AU-C 600), and mentioned it can be accessed through the AICPA's Web site.

Specifically, the engagement partner has asked you to consider what factors support the conclusion that the audit of Tiger Pride is a group audit. The partner would also like you to perform the following: (1) identify the components within the group entity to scope your work, (2) identify financially significant components, (3) determine components that are significant because of risk, and (4) determine the type of work to perform on the identified significant components.

Case Facts for Tiger Pride

Background Information

Tiger Pride consists of a corporate office and four divisions that are set up as separate legal entities (Divisions A–D). Division D is an emerging division that does not yet have a stable income. Each division has multiple business units. Each business unit has a separate general ledger, and each division consolidates its business units at the divisional level. Tiger Pride issues consolidated financial statements using consolidating reporting packages to gather financial information from the divisions.

Each business unit has its own general ledger, all transactions are processed and recorded at the business unit level, and many of the business units require statutory audits at the business unit level. The completion of some of the statutory audits is at the same time or before the completion of the audit of Tiger Pride.

Refer to the two tables below for further information:

Table A — Tiger Pride Enterprises Divisional Key Metrics.

Table B — Financial Information for Tiger Pride Enterprises Business Units.

Group materiality is $50 million.

Other Relevant Facts

On the basis of historical knowledge of the group, divisional and business unit management is well qualified and has demonstrated its ability to effectively manage its given responsibilities with the exception of the management team at Business Units 6 and 7 in Division B. (See below for further information.)

There are regular meetings between corporate management at the consolidated level and business unit management to discuss business developments and to review business unit performance. In addition, corporate management monitors business unit operations and financial results, which includes regular reporting routines. Revenue and income before tax are considered the key performance indicators by corporate management and users of the consolidated financial statements.

Tiger Pride has an effective internal audit program that is well staffed and managed. The internal audit group visits each of the business units at least once every two years with fully documented reports of the procedures performed and findings available for review.

Though each business unit maintains its own records and accounting, Tiger Pride operates on one centralized information technology (IT) system.

Business Unit Analysis

An analysis of the business units has been performed. This included reviews of each unit's historical and forecasted financial statements, statutory audit reports, internal audit reports, and discussions with management and internal audit on such matters as current-year activities, changes in the environment, and issues identified by management or internal audit.

On the basis of this analysis, the following information has been identified:

Division A, Business Unit 4: This business unit has relatively large revenue amounts ($400 million) with a sizable net loss ($50 million) incurred to date. Through discussions with management, the unit settled significant asbestos claims and other litigation during the current year resulting in payments greater than amounts accrued. The additional charges to the income statement greater than amounts accrued totaled $45 million. In addition, management indicated that expenses increased across the board that could not be recovered sufficiently through increases in sales prices or an increase in volume of sales. However, management was not able to provide sufficient explanations for the large fluctuations in a significant number of other account balances.

Division B, Business Unit 5: This unit enters into, processes, and maintains complex derivative instruments. All derivative instruments for the consolidated entity are transacted and recorded within this one business unit. The derivative instruments are in a net liability position of $60 million in the consolidated balance sheet and resulted in a current-year gain of $25 million in the consolidated income statement.

Division B, Business Unit 8: A fraud was identified in the prior year related to revenue recognition in which sales were overstated to meet bonus incentives. Extensive audit procedures were performed in the prior year, including the involvement of a fraud specialist and review of controls, to gain assurance that this fraud was (1) isolated to the lack of controls in place at this business unit and (2) isolated to the revenue cycle (revenue, accounts receivable, deferred revenue) within this business unit. Assurance was gained in the prior year that controls were in place and operating effectively in other areas of the business unit.

Division C, Business Unit 3: This unit has very low margins and through discussions with corporate management, it has been noted that a significant amount of goods have been returned because of defects. In addition, on the basis of initial discussions with business unit management and business unit personnel and through review of internal audit reports for this business unit, it appears there may be management override of controls and inappropriate tone at the top of business unit management that is encouraging the sale of defective goods.

Division C, Business Unit 4: Revenue recognition of multiple element arrangements has been identified as a significant risk. This is the only business unit with multiple element revenue arrangements and there was a significant deficiency identified in the prior year related to the controls over recording of these multiple element arrangements. Management has indicated that the deficiency was remediated in the first quarter of the current year.

***Table A* — Tiger Pride Enterprises Divisional Key Metrics**

	No. of Business Units	Revenue $ (in Millions)	Income Before Tax $ (in Millions)	Fixed Assets $ (in Millions)	Accounts Receivable and Inventory $ (in Millions)
Division A	40	4,000	280	325	800
Division B	35	3,200	400	200	600
Division C	20	2,700	300	400	750
Division D	05	1,000	25	175	300
	100	10,900	1005	1,100	2,450
Corporate office		–	(5)	2	50
	100	10,900	1,000	1,102	2,500

Table B — Financial Information for Tiger Pride Enterprises Business Units

Division A

Business Unit	Revenue $ (in Millions)	Income Before Tax $ (in Millions)	Fixed Asset $ (in Millions)	Accounts Receivable and Inventory $ (in Millions)	Statutory Audit
1	500	100	75	100	Yes
2	1,000	110	80	220	Yes
3	800	10	45	140	Yes
4	400	(50)	35	80	Yes
5	200	50	20	45	Yes
6	200	25	20	35	Yes
7	200	35	15	30	Yes
8	200	30	15	25	Yes
9	200	20	10	25	No
10–40	300	(50)	10	100	No
	4,000	280	325	800	

Division B

Business Unit	Revenue $ (in Millions)	Income Before Tax $ (in Millions)	Fixed Asset $ (in Millions)	Accounts Receivable and Inventory $ (in Millions)	Statutory Audit
1	590	105	30	95	Yes
2	510	110	30	80	Yes
3	230	55	20	65	No
4	225	(70)	25	60	No
5	25	35	2	45	No
6	350	48	20	50	Yes
7	370	47	15	45	Yes
8	150	25	15	30	No
9	100	(45)	10	30	No
10–35	650	90	33	100	No
	3,200	400	200	600	

Division C

Business Unit	Revenue $ (in Millions)	Income Before Tax $ (in Millions)	Fixed Asset $ (in Millions)	Accounts Receivable and Inventory $ (in Millions)	Statutory Audit
1	1,100	100	50	125	Yes
2	400	45	50	100	No
3	200	5	50	85	Yes
4	200	35	50	85	No
5	200	25	40	70	Yes
6	200	25	40	65	Yes
7	150	20	40	75	Yes
8	150	20	30	60	No
9	50	10	30	45	No
10–20	50	15	20	40	No
	2,700	300	400	750	

Division D

Business Unit	Revenue $ (in Millions)	Income Before Tax $ (in Millions)	Fixed Asset $ (in Millions)	Accounts Receivable and Inventory $ (in Millions)	Statutory Audit
1	730	5	90	150	Yes
2	210	15	40	80	Yes
3	50	20	20	30	Yes
4	5	(15)	20	30	No
5	5	0	5	10	No
	1,000	25	175	300	

Required:

1. On the basis of the case facts, what factors support concluding this is a group audit? Review the definitions in paragraph .11 of AICPA AU-C 600 to assist you in identifying factors you believe would indicate that a group audit exists.

2. On the basis of the definition of a component in AICPA AU-C 600, do you think the components for your group audit would be the divisions or business units?

3. In accordance with AICPA AU-C 600 and on the basis of the case facts, what might be a relevant benchmark(s) and threshold(s) for identifying the financially significant components for your group audit?

4. On the basis of the conclusion you reached in the previous question, which components would you identify as financially significant? What type of work would you perform on the financially significant components?

5. Which remaining components would you identify as significant since they are most likely to include significant risks of material misstatement to the group financial statements? What type of work would you perform on the components that you have identified as significant because of risk?

6. For the components identified as non-significant, what procedures should be performed on the transactions and account balances at the non-significant components, and what should the auditor consider when assessing the risks of material misstatement to the group financial statements, that may result from the residual balances at these non-significant components?