

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: Virtual Meeting
Meeting Date: September 8-9, 2020

Agenda Item

E

Audits of Less Complex Entities – Cover and Report Back

Objectives of Agenda Item

1. The objective of this agenda item is to:
 - (a) Provide an overview of the proposals to develop a separate standard for audits of Less Complex Entities (LCEs), as presented to the Board for discussion at the IAASB's June 2020 virtual meeting;
 - (b) Provide an update on the work being undertaken by the LCE Working Group in relation to its progress with development of a project proposal for a separate standard for Audits of LCEs; and
 - (c) Provide a report back on matters discussed at the last CAG meeting.

Project Status – What Have We Done Since We Last Met?

2. The Audits of LCEs project was discussed in April 2020, when the LCE Working Group presented to the Board further work being undertaken with regard to the way forward for IAASB action in relation to Audits of LCEs (see [Agenda Item 9](#) and related papers from the April 2020 IAASB meeting presented to the CAG at its March 2020 session). Broadly, the Board supported progressing two workstreams: one focused on Audits of LCEs (i.e., the separate standard) and one focused more broadly on the ISAs (i.e., on the complexity, understandability, scalability and proportionality (CUSP)).
3. Although both streams are being progressed, and will continue to be progressed during 2020, the IAASB had to make certain changes to its planned Board meetings due to the coronavirus pandemic. As a result, only the workstream relating to the development of the separate standard was discussed in June 2020. However, targeted timelines for both streams, at this stage, are still on track.
4. **Agenda Item E.2** sets out the proposals for developing a separate standard for Audits of LCEs that was presented to the IAASB for discussion at the June 2020 IAASB meeting. Agenda Item E.2 explains the basis for the development of the separate standard, i.e., using overarching principles that would guide the development of the separate standard. The Board broadly supported that the LCE Working Group commence development of the separate standard for Audits of LCEs on this basis, although the LCE Working Group was asked to further consider certain principles (including application material within the separate standard as well as how the separate standard will 'link' back to the full set of ISAs). The LCE Working Group is working towards presenting a project proposal, and a first draft of the separate standard, to the IAASB for discussion in December 2020. Discussions with the Board on the work of the CUSP workstream are planned for January 2021, where proposals for the drafting principles and guidelines will be discussed.
5. **Appendix A** to this paper provides a history of previous discussions with the IAASB CAG and IAASB

on this topic, including links to the relevant IAASB CAG documentation.

Matters for IAASB CAG Consideration with Respect to the Issues and Recommendations

6. The IAASB CAG is asked to provide feedback about the LCE Working Group's basis for developing a separate standard for Audits of LCEs as set out in the presentation to this agenda item.

Material Presented – IAASB CAG Papers

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| Agenda Item E.1 | Audits of Less Complex Entities—Presentation |
| Agenda Item E.2 | Audits of Less Complex Entities—Issues and Recommendations (Replica of IAASB June 2020 Issues Paper) |

Feedback – What Did We Hear Last Time We Met?

7. Extracts from the minutes of the March 2020 IAASB CAG meeting, as well as an indication of how the LCE Working Group or IAASB has responded to the Representatives' comments, are included in the table below.

| Representatives' Comments | Working Group/IAASB Response |
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| PROPOSED DIRECTION FORWARD IN RELATION TO AUDITS OF LCEs | |
| Messrs. De Tullio and Hansen explained that the Financial Accounting Standards Board (FASB) had recently published a <i>Guide for Small Businesses</i> which provides a deferred application date for certain pronouncements and that it may be useful for the LCE Working Group to consider further learning from the FASB how the guide, and especially how the delayed effectiveness of the standards, has been structured. | Point noted. While developing proposed actions focusing on Audits of LCEs, the LCE Working Group has explored relevant considerations and learnings from the experiences of other standard setting boards, as well as from those jurisdictions who have already developed solutions for Audits of LCEs. As the work on the development of the separate standard for Audits of LCEs progresses, the LCE Working Group will further consider any relevant learnings from these important sources. |
| Mr. De Tullio supported the LCE Working Group's proposed way forward to consider a multi-workstream approach to address the challenges with Audits of LCEs. He questioned whether it would be more practicable to take an approach to first revise the | Prof. Simnett noted that the revision of some standards which respondents to the DP ¹ noted as especially challenging for LCEs (such as ISA 315 (Revised) ² and ISA 540 (Revised)) ³ had already been recently revised and therefore for |

¹ Discussion Paper (DP), Audits of Less Complex Entities (LCEs): *Exploring Possible Options to Address the Challenges in Applying the ISAs*

² ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.

³ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*.

| Representatives' Comments | Working Group/IAASB Response |
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| <p>standards that are presently in draft (for example ISA 220 and ISA 600) rather than revising all the ISAs in a single substantial project.</p> | <p>those standards it would be difficult to make further revisions at this stage. He added that for the standards forming part of the quality management standards series,⁴ this approach could possibly be considered but noted that it may be too late in the process considering the stage of these projects.</p> <p>Prof. Simnett also highlighted that before any revisions to the ISAs could be made, there are steps which need to be undertaken including the development of drafting principles and guidelines for a revised presentation of the standards. He noted that once these drafting principles and guidelines had been developed, only then could they then be applied to any standards under revision.</p> <p>Prof. Simnett also added that respondents to the DP had noted that guidance within methodologies had proved to have some success in assisting engagement teams in managing some of the challenges relating to audit work for smaller entities, and the LCE Working Group therefore planned to further understand the nature and extent of this guidance to determine whether it could help inform the IAASB's work efforts in this area. He further explained that this could be done through further understanding various methodologies and related guidance being used for audits of smaller entities, such as those used by Big 4 accounting firms.</p> |
| <p>Mr. Thompson inquired about the percentages of the respondents to the DP who agreed with the options proposed.</p> | <p>Prof. Simnett and Ms. Bahlmann explained that there had been mixed views from respondents about the options proposed in the DP, with no overwhelming clear majority for any of the options as the only solution. It was noted that respondents recognized the need to revise the</p> |

⁴ The quality management standards series includes three exposure drafts, International Standard on Quality Management (ISQM) 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements*; ISQM 2, *Engagement Quality Reviews*, and International Standard on Auditing (ISA) 220 (Revised), *Quality Management for an Audit of Financial Statements*.

| Representatives' Comments | Working Group/IAASB Response |
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| | ISAs as an ideal solution, but acknowledged this would not be practicable in the short term, and therefore the option of the separate standard as an effective and efficient approach in the shorter term was supported. |
| Mr. Hansen had the view that “an audit is an audit,” and therefore practitioners would need to read and understand the standards in order to apply them effectively. He cautioned of the risk of creating a two standard regime where Audits of LCEs may be considered a “light audit” category, which may adversely affect the profession. | Mr. Botha confirmed that it is possible to achieve reasonable assurance in different ways, noting that as this had already been achieved by IAASB with other standards, it could be possible with respect to the development of a separate standard for Audits of LCEs. |
| Messrs. Hirai and Hansen and Ms. Landell-Mills emphasized that should a separate standard for Audits of LCEs be developed, then the description of LCEs should explicitly exclude listed companies, companies with public accountability and those with public debt, so as to avoid application of the separate auditing standard to those entities based on interpretation. | <p>Point noted. Because the separate standard for Audits of LCEs will be developed taking into account the specific characteristics of an audit of an LCE, the LCE Working Group acknowledges that it may not be suitable for audits of certain types of entities (for example listed entities). The LCE Working Group acknowledges that further work is needed to determine the appropriate applicability of the separate standard for Audits of LCEs, including the types of entities for which the standard would not be suitable. Further, Mr. Seidenstein emphasized the notable and increasing stock of standards addressing Audits of LCEs being developed by various jurisdictions and regions world-wide. He added that one of the decisions that would need to be considered going forward is the scope of the separate standard, i.e., for which companies it would be suitable, taking into account the strong preference that listed companies and those with public accountability be excluded from the scope.</p> <p>At the June 2020 IAASB meeting the IAASB expressed a strong preference to exclude listed entities from being able to use the standard.</p> |
| As a number of CAG members could not attend this session, Mr. Dalkin reminded participants that during previous CAG discussions, CAG Representatives | Mr. Seidenstein noted that through the development of drafting principles and guidelines for a revised presentation of the |

| Representatives' Comments | Working Group/IAASB Response |
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| encouraged that a “building-blocks approach” be considered as a possible approach to revising the ISAs (with a goal of achieving reasonable assurance). | standards, the scalability of the standards to their “building-blocks” may be addressed. |
| Ms. Robert questioned whether there would be convergence between the proposed workstreams planned at some time in the future. She further explained that if the “building-blocks” had been properly identified then the separate standard would be the first building block. | Prof. Simnett and Ms. Bahlmann explained that at this point it would be difficult to anticipate whether, and/or at which point, both workstreams may converge, however this would be considered as the projects were progressed and a decision made at a later time. It was highlighted that the work under both workstreams would inform the other, and the LCE Working Group anticipates many synergies between the workstreams. |
| PIOB COMMENTS | |
| Mr. Kashiwagi emphasized that at the last CAG meeting where this topic was discussed (in March 2019), a strong concern had been expressed on developing a separate standard for Audits of LCEs as this may lead to a “two-tier” profession. He therefore encouraged that there is just one set of standards. In addition, he highlighted that securities regulators have a strong preference for audits of listed companies and companies with public debt to be based on a single, high quality auditing standards, as is the case with the current ISAs, without consideration if the entity is complex or less complex. He also added that further consideration should be given to the timing of the proposals. | Point noted. |

Appendix A

Project Details and History

Project: Audits of Less Complex Entities

Link to IAASB Project Pages:

- [Audits of Less Complex Entities Project Page](#)
- [Complexity Understandability Scalability Proportionality \(CUSP\)](#)

Working Group Members⁵

LCE Working Group (up to June 2020)

The LCE Working Group comprises:

- Roger Simnett, IAASB Member and Task Force Chair
- Chun Wee Chiew, IAASB Member and IFAC SMP Committee Liaison
- Kai Morten Hagen, IAASB Member
- Rich Sharko, IAASB Member
- Isabelle Tracq-Sengeissen, IAASB Member and IFAC SMP Committee Liaison
- Brendan Murtagh, Past IAASB Member
- Gordon Cummings, CPA Canada, past member of Canadian Auditing and Assurance Standards Board
- Christopher Arnold – IFAC SMP Committee Representative

LCE Working Group (from July 2020)

- Kai Morten Hagen, IAASB Member and Task Force Chair
- Julie Corden, IAASB Member
- Chun Wee Chiew, IAASB Member and IFAC SMP Committee Liaison
- Vivienne Bauer, IAASB Technical Advisor
- Brendan Murtagh, Past IAASB Member
- Christopher Arnold, IFAC SMP Committee Representative
- Roger Simnett, IAASB Member (Correspondent Member)

CUSP Working Group (from July 2020)

- Roger Simnett, IAASB Member and Task Force Chair
- Isabelle Tracq-Sengeissen, IAASB Member
- Eric Turner, IAASB Member

⁵ Following the June 2020 IAASB Virtual meeting, the LCE Working Group composition was changed. In addition a new Working Group was set up that will focus on issues identified with the ISAs in relation to complexity, understandability, scalability and proportionality (CUSP Working Group) (i.e. for the ISA focused workstream).

- Tania Sergott, IAASB Technical Advisor
- Kohei Yoshimura, IAASB Technical Advisor

Summary

| | IAASB CAG Meeting | IAASB Meeting |
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| Project commencement and preliminary discussions on audit issues relevant to Audits of Less Complex Entities | March 2017 September 2017 | March 2017 March 2018 (Executive session) |
| Discussion on the proposal to undertake work to develop a Discussion Paper to obtain stakeholder views on matters related to issues and challenges when auditing less complex entities | September 2018 | September 2018 |
| Discussion on the IAASB's proposed Discussion Paper, <i>Audits of Less Complex Entities: Exploring Possible Actions to Address the Challenges</i> . | March 2019 | March 2019 |
| Audit of Less Complex Entities – Discussion on way forward regarding audits of less complex entities | March 2020 | December 2019 April 2020 June 2020 |

IAASB CAG Discussions: Detailed References

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| Information gathering | <u>March 2017</u> See IAASB CAG meeting material (Agenda Item G) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting <u>September 2017</u> See IAASB CAG meeting material (Agenda Item C) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain |
| Work Proposal | <u>September 2018</u> See IAASB CAG meeting material (Agenda Item I) and meeting minutes (Agenda Item A) http://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-0 |
| Discussion of IAASB's proposed Discussion Paper, Audits of Less | <u>March 2019</u> See IAASB CAG meeting material (Agenda Item E) and meeting minutes: |

Audits of Less Complex Entities
IAASB CAG Public Session (September 2020)

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| Complex Entities: Exploring Possible Actions to Address the Challenges | https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1 |
| Discussion of further matters for Board consideration in relation to Audits of LCEs | <u>March 2020</u> See IAASB CAG meeting material and CAG meeting minutes (Agenda Item N) https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-3 |