

Meeting: IAASB Consultative Advisory Group (CAG)
Meeting Location: Virtual Meeting
Meeting Date: December 1, 2020

Agenda Item

A

Audits of Less Complex Entities – Cover

Objectives of Agenda Item

1. The objective of this agenda item is to obtain Representatives views on the project proposal for development of a separate standard to audit the financial statements of a less complex entity (LCE).

Project Status

2. The proposal to develop a [draft] audit standard for audits of LCEs, as well as the principles upon which that draft would be developed, was presented to the IAASB for discussion at the June 2020 IAASB meeting. The Board broadly supported that the LCE Working Group commence development of the [draft] audit standard on this basis (see [Agenda Item 4](#) and related papers from the June 2020 IAASB meeting). These matters were discussed with the CAG at its September 2020 meeting – see [Agenda Item E](#) from the September CAG meeting. **Appendix B** to this paper sets out the Draft CAG minutes from the September 2020 CAG meeting.
3. At the June IAASB meeting, the Board also agreed that the project proposal could be presented at the same time as the initial draft of the [draft] audit standard (because of the change to virtual meetings some IAASB topics may not have been discussed in plenary as would ordinarily be the case, but work has continued to be progressed). Accordingly, the LCE Working Group will be presenting the project proposal, an issues paper explaining how the draft is being developed and matters for IAASB considerations, as well as the initial draft of the [draft] audit standard, to the IAASB for discussion in December 2020 (see [Agenda Item 2-A](#) and related papers for the December 2020 IAASB meeting).
4. **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

5. In this meeting, Representatives are asked for views on the project proposal presented in **Agenda Item A.1.** to set out the objective, scope and actions to develop the [draft] audit standard for audits of the financial statements of LCEs
6. The other Agenda items to be discussed at the IAASB December 2020 meeting, including the initial draft of the audit standard and the IAASB CAG report back from the September 2020 session will be discussed with the IAASB CAG at its March 2021 meeting.

Material Presented – IAASB CAG Papers

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| Agenda Item A.1 | Project Proposal —Developing a Separate Standard for Audits of Less Complex Entities |
| Agenda Item A.2 | Project Proposal for Audits of Less Complex Entities—Presentation |

Appendix A

Project Details and History

Project: Audits of Less Complex Entities

Link to IAASB Project Page: [Audits of Less Complex Entities Project Page](#)

Working Group Members

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

Summary

| | IAASB CAG Meeting | IAASB Meeting |
|--|------------------------------|--|
| 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 September 2020 | December 2019 April 2020 June 2020 |

IAASB CAG Discussions: Detailed References

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| Information gathering | <p><u>March 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item G) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting</p> <p><u>September 2017</u></p> <p>See IAASB CAG meeting material (Agenda Item C) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-madrid-spain</p> |
| Work Proposal | <p><u>September 2018</u></p> <p>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</p> |
| Discussion of IAASB's proposed Discussion Paper, Audits of Less Complex Entities: Exploring Possible Actions to Address the Challenges | <p><u>March 2019</u></p> <p>See IAASB CAG meeting material (Agenda Item E) and meeting minutes: https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-new-york-ny-1</p> |
| Discussion of further matters for Board consideration in relation to Audits of LCEs | <p><u>March 2020</u></p> <p>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</p> <p><u>September 2020</u></p> <p>See IAASB CAG meeting material (Agenda Item E) https://www.iaasb.org/cag/meetings/iaasb-cag-meeting-virtual-videoconferencing</p> |

Draft CAG Minutes¹ – September 2020

Audits of Less Complex Entities (LCEs) (Agenda Item E)

To *PROVIDE* Representatives' with an overview of the proposals to develop a separate standard for audits of Less Complex Entities (LCEs) and on the information-gathering activities with respect to the complexity, understandability, scalability and proportionality (CUSP) workstream; and to *OBTAIN* Representatives' views of the work being undertaken by the LCE and CUSP Working Groups.

Prof. Simnett, Chair of the CUSP Working Group and Mr. Hagen, Chair of the LCE Working Group introduced the topic, explaining the work within the two streams respectively.

PROPOSED DIRECTION FORWARD IN RELATION TO CUSP WORKSTREAM

Representatives commented as follows:

- Messrs. Thompson and Pavas and Ms. Robert supported the direction of the IAASB on the two workstreams. Ms. Manabat emphasized the importance of this work for the IAASB.
- Messrs. Hansen and Hirai inquired whether the CUSP workstream would clarify the differences and distinctions between how “proportionality” and “scalability” are referred to with respect to the IAASB standards. They explained that it would be helpful to provide further clarity concerning the meaning of the terminology applied as it was currently not clear what each workstream would address and there could be duplication of efforts if these terms were not clearly understood. Prof. Simnett explained that as part of the CUSP workstream the working group would further explore these terms and clarify as appropriate. He also noted that it is envisioned that the separate standard workstream would also address scalability and proportionality in the context of audits of LCEs.
- Mr. Cela noted that the work of both workstreams are interrelated, and therefore it is very important that both workstreams progress in parallel. Prof. Simnett agreed and noted that as the work is progressing under both workstreams, it is important that information and learning beneficial for both workstreams is shared between the CUSP and LCE Working Groups. He also noted that both workstreams are being supported by the same IAASB staff to enhance this coordination.
- Ms. Zietsman and Mr. De Tullio recognized the importance of the work being performed in both workstreams. They highlighted that the CUSP workstream would impact all the ISAs, and that the work envisioned under this workstream is not specific to less complex entities only. Ms. Zietsman noted that some of the IAASB Clarity conventions were not used consistently, and added that there had been more complexity introduced to the standards in the more recent IAASB projects (such as ISA 315 (Revised 2019)² and ISA 540 (Revised)³). Mr. Pavas agreed that the complexity of the ISAs had increased and welcomed the IAASB's efforts in this regard. Ms. Zietsman also emphasized the need to develop a strategy about how any changes to the standards would be

¹ These draft CAG minutes are still subject to review and therefore may further change.

² ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

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

applied once the drafting principles and guidelines have been finalized in order to prevent unintended changes to the ISAs. Prof. Simnett explained that the decision on how the standards will be revised will be considered further by the IAASB once the drafting conventions and guidelines have been finalized, but noted that there is a preference for revisions to be made on a prospective basis, i.e., as standards are opened up for revisions on a going forward basis.

- Mr. Norberg questioned if it would be possible to evaluate how the two workstreams would run in parallel considering their different development approaches, i.e., the CUSP workstream being at an information gathering stage (and seemed to be more of a desktop process), while the development of the separate standard for audits of LCEs standard-setting and including more extensive outreach activities. Mr. Seidenstein noted that the work of the CUSP Working Group would start to feed into current projects of the IAASB, as standards are opened up and revised the principles will start to be applied. He further explained that the projects were different in nature, and that the development of the separate standard necessitated a separate reference group to help the development of a usable and appropriate standard in the very short timeline.
- Mr. Dalkin highlighted that the ISAs have increased in volume over the recent past and encouraged the CUSP workstream to also consider the root causes of why this had occurred. Prof. Simnett acknowledged the importance for understanding the root causes, and noted that a detailed review was performed when the responses to the Discussion Paper⁴ were analyzed.

PROPOSED DIRECTION FORWARD IN RELATION TO AUDITS OF LCEs

Representatives commented as follows:

- Mr. Munter and Ms. Wei emphasized that while developing the separate standard for audits of LCEs it is important to achieve the objective of a high-quality audit, regardless of the size of the entity and its complexity. Ms. Wei encouraged the LCE Working Group to consider how the audit opinions of entities audited under the separate standard would impact the future potential access of LCEs to the capital market given that investors expect the same high-quality financial information and audits from companies of all sizes and complexities. Prof. Simnett and Mr. Hagen noted that the development principles of the separate standard for audits of LCEs underline that the standard will be developed with the same level of assurance as the ISAs (i.e., reasonable assurance) and that under both approaches the quality of the audit will not be compromised.
- Messrs. Yurdakul, Yoshii, Munter and Hansen and Ms. Landell-Mills and Singh highlighted that in previous discussions representatives' had expressed concerns that a separate standard for audits of LCEs could result in lower quality audits being performed (because of weaker standards), and a "two-tier" system of audits. It was explained that having one set of global auditing standards would prevent such risk, notwithstanding the pressure from local and regional standard setters who are seeking solutions for audits of LCEs. Mr. Hansen and Ms. Landell-Mills cautioned that public interest entities (PIEs) should be scoped out in addition to listed entities. Mr. Hagen noted that the IAASB would carefully consider what needed to be done to not create a two-tier system, or the perception that an audit using the separate standard was of a different quality. He explained that

⁴ Discussion Paper (DP), Audits of Less Complex Entities (LCEs): *Exploring Possible Options to Address the Challenges in Applying the ISAs*

the principles for the development of the separate standard were based on the ISAs, and in that way it was envisioned that a high-quality audit would be performed using the separate standard.

- Mr. Ruthman emphasized the importance of the applicability of the separate standard. He further explained that further consideration would need to be given to when entities beyond listed entities are 'scoped out' and how they may be impacted if unable to use the standard, for example, if entities using public funding are scoped out this may inadvertently potentially scope out some public sector entities when they may be less complex by nature.
- Ms. Mubarak supported the development of a separate standard for audits of LCEs. She cautioned that simplification may not be as easy as it may first appear for some topics (such as procedures to verify the estimates used in financial statements or with respect of audits of group financial statements). She highlighted that Sri Lanka has developed a separate standard for auditing very small and economically non-significant entities, and that auditors have the option to use this standard provided the applicability criteria are met.
- Mr. Sobel supported the use of a decision tree (as presented in the IAASB June 2020 issues paper) to assess applicability, but noted that it may be necessary to provide further clarity as to the degree of professional judgement that would be needed when making such determination. Mr. Hagen explained that the LCE Working Group's thinking had further evolved since the IAASB June 2020 paper and that further changes to the applicability of the separate standard (and flowchart) are currently being developed. He noted that the LCE Working group was focused on the complexity of the audit and had heard from other outreach that the applicability needed to be clear, and less judgmental (or more prescriptive).
- Ms. Robert noted general support for the principles that had been set out for the development of the separate standard. She also encouraged further outreach with legislators and regulations in various jurisdictions, as they would impact the decision to apply the separate standard in those jurisdictions, and it would be helpful to connect with these stakeholders as early as possible to obtain their support. She also highlighted outreach with the LCE Reference Group as a good source of practical and technical knowledge, noting that the group was mainly composed of practitioners.
- Mr. Cela supported the development of the separate standard, and indicated that such standard will be applicable for compulsory and contractual audits of LCEs, and would help those jurisdictions that are seeking and developing solutions for audits of LCEs.
- Mr. Rees expressed support for development of the separate standard. He highlighted that the International Accounting Standard Board (IASB) is currently consulting on the future of its IFRS for SME Standard.⁵ He noted that some of the questions that the IASB is thinking about could be useful context for the development of the IAASB's separate standard for audits of LCEs, such as whether the IFRS for SME Standard should continue to align with full IFRS or could the requirements be developed more independently from the full IFRS. He highlighted the importance of the applicability to determine who can use the separate standard as that will affect its content and how the standard is drafted.

⁵ International Financial Reporting Standard for Small and Medium-sized Entities

- Mr. Dalkin noted that it would also be useful to consider if there would be any unintended consequences when developing the separate standard for audits of LCEs, including the determination of its applicability.

PIOB COMMENTS

Mr. Kashiwagi highlighted the concerns previously raised with respect to the allocation of resources to these projects and the length of time for the work envisioned under both workstreams. He emphasized the need for the workstreams to progress in shorter timelines, considering the urgent need for these projects. Mr. Seidenstein explained that work on both projects has been progressing very quickly and it is envisioned that an Exposure Draft for the separate standard for audits of LCEs will be published mid-2021, at the same time it is envisioned that the drafting principles and guidelines will also be published for public consultation.

WAY FORWARD

Prof. Simnett and Mr. Hagen thanked the Representatives for their feedback. 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 is planned for January 2021, where proposals for the drafting principles and guidelines will be discussed.