

Agenda Item B.3 For Reference

Please note: This is an IAASB LCE Agenda Paper that will be discussed by the Board at the September 2022 IAASB quarterly meeting (Agenda Item 5-A). This paper is provided to the IAASB CAG Representatives in September 2022 for reference purposes.

Audits of Less Complex Entities – Proposed Authority

This agenda item presents revised drafting of Part A, *Authority of the ISA for Audits of Financial Statements of Less Complex Entities* and is tracked from the version presented at the [June 2022 Board Meeting](#).

A. **[Draft]** Authority of the ISA for Audits of Financial Statements of Less Complex Entities

Content of this Part

Part A ~~describes when the ISA for LCE is appropriate for use in undertaking an audit engagement. The standard is designed to enable the achievement of the overall objectives of the auditor, given the typical nature and circumstances of an LCE. There are limitations to the use of the ISA for LCE. sets out which include~~ specific prohibitions, qualitative characteristics, ~~and quantitative thresholds~~ used for determining if the ~~[draft] standard is appropriate for use in an audit of the financial statements of an LCE.~~ Part A also describes the responsibilities for legislative or regulatory authorities or relevant local bodies with standard-setting authority to support the appropriate use of the standard.

~~For the purposes of this Part, the use of “LCE” or “entity” also refers to a group (i.e., where the audit is an audit of group financial statements).¹~~

The requirements in this ~~[draft]~~ ISA for LCE have been designed to be proportionate to the typical nature and circumstance of an audit of an LCE (i.e., they do not address complex matters or circumstances). ~~This [draft] ISA for LCE is not permitted to be used for audits that are not audits of financial statements of LCEs.~~ If the ~~[draft]~~ ISA for LCE is used for an audit outside the intended scope of this ~~[draft]~~ standard, compliance with the requirements of the ~~[draft]~~ ISA for LCE will not be sufficient for the auditor to obtain sufficient appropriate audit evidence to support a reasonable assurance opinion.

~~The responsibilities of legislative or regulatory authorities or relevant local bodies in determining the Authority of the standard for a specific jurisdiction are described at the end of this Part. The Supplemental Guidance for the Authority of the Standard (the Authority Supplemental Guide) provides further guidance for legislative or regulatory authorities or relevant local bodies with standard-setting authority when addressing their respective responsibilities as described in this Part.~~

~~In addition, the Supplemental Guidance for the Authority of the Standard (the Authority Supplemental Guide),~~ further explains matters that may be relevant in the determination of use of the ~~[draft]~~ ISA for LCE for firms and auditors.

¹ As defined in **Appendix 1**, “group” is a reporting entity for which group financial statements are prepared and “group financial statements” are financial statements that include the financial information of more than one entity or business unit through a consolidation process. In addition, the term consolidation process refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions.

Limitations for Using the ~~[Draft]~~ ISA for LCE

Limitations for using the ~~[draft]~~ ISA for LCE are designated into ~~{three}~~ categories:

- Specific classes of entities for which the use of the ~~[draft]~~ ISA for LCE is prohibited (i.e., specific prohibitions);
- Qualitative characteristics that describe an LCE, and if not exhibited by an entity would ~~generally~~ordinarily preclude the use of the ~~[draft]~~ ISA for LCE for the audit of the financial statements of that entity; and
- Quantitative thresholds to be determined by ~~the~~ legislative or regulatory authorities or relevant local bodies with standard-setting authority in each jurisdiction.

In determining the use of the ~~[draft]~~ ISA for LCE, all three categories ~~{are required}~~ to be considered.

Specific Prohibitions

Paragraph A.1. sets out the classes of entities for which the use of this ~~[draft]~~ standard is specifically prohibited.

A.1. The ~~[draft]~~ ISA for LCE shall not be used if:

- (a) Law or regulation:
 - ~~(i) Explicitly~~ prohibits the use of the ~~[draft]~~ ISA for LCE ~~(i.e., the [draft] standard is not broadly authorized for use in a particular jurisdiction);~~ or
 - ~~(ii) s~~Specifies the use of auditing standards, other than the ~~[draft]~~ ISA for LCE, for an audit of financial statements in that jurisdiction.
- (b) The entity is a listed entity.
- (c) ~~An~~The entity ~~falls into~~meets one of the following classes~~criteria~~:²
 - (i) An entity one of whose main functions is to take deposits from the public;
 - (ii) An entity one of whose main functions is to provide insurance to the public;
 - (iii) ~~[An entity whose function is to provide post-employment benefits];~~
 - (iv) ~~[An entity whose function is to act as a collective investment vehicle and that issues redeemable financial instruments to the public];~~ or
 - (v) A class of entities where use of the ~~[draft]~~ ISA for LCE is prohibited for that specific class of entity by a legislative or regulatory authority or relevant local body with standard-setting authority in the jurisdiction.
- (d)- The audit is an audit of group financial statements³ and:
 - (i) Any of the group's individual entities and business units meets the criteria as described in paragraph A.1.(b) or A.1.(c); or

² As described in paragraph 11 of **Agenda Item 5**, for the purposes of initial revisions, brackets have been added around the two classes that would need to be removed in order to align A.1.(c) with the IESBA Public Interest entity (PIE) definition, however further coordination will continue with the IAASB's Task Force exploring whether changes should be made in the ISAs and International Standards on Quality Management (ISQMs) for the IESBA's Listed Entity & PIE definition.

³ Consistent with the proposed ISA-600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, group financial statements are financial statements that include the financial information

(ii) [Component auditors are involved.]⁴

- A.2. The classes in paragraph A.1.(a) (b) and (d) are outright prohibitions and cannot be modified. Legislative or regulatory authorities or relevant local bodies with standard-setting authority can modify each class described in paragraph A.1.(c) but a class cannot be removed.

A.1.(c) sets out some classes of entities that may exhibit public interest characteristics. Entities that have public interest characteristics could embody a level of complexity in fact or appearance and are specifically prohibited from using the ~~[draft]~~ ISA for LCE. Modifications can be made by adding a class of entities to the list of prohibited entities, permitting specific sub-sets within a class to be able to use the ~~[draft]~~ standard or using quantitative thresholds to prohibit use of the ~~[draft]~~ standard. Legislative or regulatory authorities or relevant local bodies with standard-setting authority may subsequently remove or amend modifications that they have made.

Qualitative Characteristics

The requirements in this ISA for LCE have been designed to be proportionate to the typical nature and circumstance of an audit of an LCE.

The ISA for LCE has not been designed to address:

- Complex matters or circumstances relating to the nature and extent of the entity's business activities, operations and related transactions and events relevant to the preparation of the financial statements.
- Topics, themes and matters that increase, or indicate the presence of, complexity, such as those relating to ownership, corporate governance arrangements, policies, procedures or processes established by the entity.

~~The following list is not exhaustive and other relevant matters may also need to be considered. Each of the qualitative characteristics may on its own not be sufficient to determine whether the ~~[draft]~~ ISA for LCE is appropriate or not in the circumstances, therefore the matters described in the list are intended to be considered both individually and in combination. The characteristics are not intended to be absolute, i.e., if an entity does not exhibit all of these characteristics it would not necessarily exclude the use of ~~[draft ISA for LCE]~~ for that entity.~~

~~Notwithstanding that professional judgment is applied in determining whether the standard is appropriate to use, if there is uncertainty about whether an audit meets the criteria as set out in this Authority, the use of the ISA for LCE is not appropriate.~~

Also, the ISA for LCE does not include any requirements addressing:

- (a) Procedures or matters typically relevant to listed entities, including reporting on segment information or key audit matters.
- (b) When the auditor intends to use the work of internal auditors, as this would ordinarily not be applicable to an audit of a typical LCE.

- A.3. The following list describes characteristics of a typical LCE for the purpose of determining the appropriate use of the ISA for LCE. The list is not exhaustive nor intended to be absolute, and

~~of more than one entity or business unit through a consolidation process. The term consolidation process refers not only to the preparation of consolidated financial statements in accordance with the applicable financial reporting framework, but also to the presentation of combined financial statements, and to the aggregation of the financial information of entities or business units such as branches or divisions.~~

⁴ For discussion - see paragraphs 58—64 of **Agenda Item 5** for the Task Force views on the potential inclusion of a limitation in relation to the involvement of Component Auditors.

other relevant matters may also need to be considered. Each of the qualitative characteristics may on its own not be sufficient to determine whether the ISA for LCE is appropriate or not in the circumstances. Therefore, the matters described in the list are intended to be considered both individually and in combination. For the purpose of audits of group financial statements, these considerations shall apply to both the group and each of its individual entities and business units. ~~The [draft] ISA for LCE is appropriate for the audit of the financial statements if the entity exhibits the following characteristics:~~

<u>Business Activities, Business Model & Industry</u>	<p>The entity's business activities, business model or the industry in which the entity operates does not give rise to significant pervasive business risks.</p> <p>and there are no specific laws or regulations that govern the business activities that add complexity (e.g., prudential requirements).</p> <p>The entity's transactions result from few <u>lines of</u> business activities or revenue streams.</p>
<u>Organizational Structure and Size</u>	<p>The organizational structure is relatively straightforward, with few reporting lines or levels and a small key management team (e.g., generally 5 individuals or less).</p>
<u>Ownership Structure</u>	<p>The entity's ownership structure <u>is straightforward and there is</u> facilitates clear transparency of ownership and control, <u>such that all individual owners and beneficial owners are known</u>.</p>
<u>Nature of Finance Function</u>	<p>The entity has a centralized finance function, including centralized activities related to financial reporting, and with.</p> <p><u>There are</u> few employees involved in financial reporting roles (e.g., generally 5 individuals or less).</p>
<u>Information Technology (IT)</u>	<p>With regard to the entity's information technology: <u>The IT environment of the entity, including its IT applications and IT processes, is straightforward.</u></p> <p>The entity uses commercial software and does not have <u>the ability</u> access to the source code to make any program changes <u>other than to configure the software</u> (notwithstanding the ability to configure the software (e.g., the chart of accounts, reporting parameters or thresholds)).</p> <p>Access to the software is generally <u>limited to</u> one or two designated individuals <u>for the purpose of</u> with administrative access to the software to make making the configurations.</p> <p>Few formalized general IT controls are needed in the entity's circumstances.</p>

<u>Application of the Financial Reporting Framework and Accounting Estimates</u>	<p>When there is a need for significant management judgment in the application of the financial reporting framework, it involves few accounts <u>or disclosures in the financial statements of the entity necessitate the use of significant management judgment in applying the requirements of the financial reporting framework and any related significant risk(s) of material misstatement (e.g., resulting from estimation uncertainty) is not pervasive to the entity and the financial statements as a whole.</u></p> <p><u>The entity financial statements typically do not include accounting estimates that involve the use of complex methods or models, assumptions or data.</u></p>
<u>Additional Characteristics Relevant for Audits of Group Financial Statements</u>	
<u>For audits of group financial statements, the following qualitative characteristics are to be considered in addition to those above:</u>	
<u>Group Structure and Activities</u>	<p><u>The group has few entities or business units (e.g., 5 or less).</u></p> <p><u>Group entities or business units are limited to few jurisdictions or geographical locations (e.g., 5 or less).</u></p>
<u>Access to Information or People</u>	<u>Management can provide access to all information and people within the group relevant to the preparation of the group financial statements.</u>
<u>Consolidation Process</u>	<u>The group has a simple consolidation process (e.g., no complex sub-consolidations, simple aggregation/-consolidation adjustments, non-complex intercompany transactions).</u>
<u>Financial Reporting Process</u>	<p><u>Financial information of all entities or business units have been prepared in accordance with the same accounting policies applied to the group financial statements.</u></p> <p><u>All entities or business units have the same financial reporting period-end as that used for group financial reporting.</u></p>

Notwithstanding that professional judgment is applied in determining whether the standard is appropriate to use, if there is uncertainty about whether an audit meets the criteria as set out in this Authority, the use of the ISA for LCE is not appropriate.

Quantitative Thresholds

A.4. This Part provides for legislative or regulatory authorities or relevant local bodies with standard setting authority to determine quantitative threshold(s) for use of the ISA for LCE. The [draft] ISA for LCE is inappropriate if the following thresholds have been exceeded by the entity in the financial year [or equivalent] subject to audit:

- (a) — [Employee headcount: [designated by jurisdiction] [and/or]
- (b) — Revenue of [designated by jurisdiction] [and/or]
- (c) — Net Assets of [designated by jurisdiction] [and/or]

~~(d) — [Other]~~

Setting quantitative thresholds assists in the consistent use of the ISA for LCE in a jurisdiction. Guidance on setting quantitative thresholds is described further in the Authority Supplemental Guide. Quantitative thresholds may be set, for example, for all entities within the jurisdiction in general, or for entities within a specific or certain industry(ies) or for certain classes of entities.

When determining whether the ISA for LCE is appropriate to use, quantitative thresholds are to be considered in addition to the specific prohibitions in paragraph A.1. and the qualitative characteristics in paragraph A.3.

Responsibilities of Legislative or Regulatory Authorities or Relevant Local Bodies

Decisions about the required or permitted use of the IAASB's International Standards (including the International Standards on Auditing (ISAs) and the ISA for LCE) rest with legislative or regulatory authorities or relevant local bodies with standard-setting authority (such as regulators or oversight bodies, jurisdictional / national auditing standard setters, professional accountancy organizations or others as appropriate) in individual jurisdictions. ~~This applies to the International Standards on Auditing (ISAs) and the [draft] ISA for LCE.~~

As part of the local adoption and implementation process, legislative or regulatory authorities or relevant local bodies with standard-setting authority:

- ~~M~~may add or modify the classes of entities in paragraph A.1.(c) as set out in paragraph A.2.
- ~~A~~are required to [encouraged to] anticipated to determine ~~the~~ quantitative thresholds described in paragraph A.4.

In doing so, the specific prohibitions, ~~and the~~ qualitative characteristics and quantitative thresholds should be considered, as well as other specific needs that may be relevant in the jurisdiction. The Authority Supplemental Guide may be helpful when determining the permitted use of the ~~[draft]~~ standard for a jurisdiction.