

### Audits of Less Complex Entities – Development of a Separate Standard

#### Objective of the Meeting

1. To obtain the Board’s views and input on the draft International Standard on Auditing for Financial Statements of Less Complex Entities (the “draft ISA for LCE”) (**Agenda Item 4-A**) so that the LCE Task Force (the Task Force) can continue to develop the standard for exposure in early July 2021 (i.e., a targeted approval of the exposure draft (ED) by the IAASB in June 2021).

#### Board Discussion:

2. The majority of the Board time for this topic will be focused on the discussion of the draft ISA for LCE in **Agenda Item 4-A**. However, there will be some time allocated for discussion of the “mapping” documents (**Agenda Items 4-B(1) and 4-B(2)**):

#### *Draft ISA for LCE*

3. The Task Force Chair will walk-through the draft ISA for LCE (**Agenda Item 4-A**), from front to back, stopping on each Part for Board views about any aspects of that Part. For example, comments or views are needed about the requirements or other material within each Part, or whether there is anything missing that would have been expected within the Part), and including but not limited to any specific “Matters for Board Consideration” set out at the end of this agenda item.

#### *Mapping Documents*

4. Once the walk-through of the draft ISA for LCE is complete, the remaining time will be spent on the mapping documents in **Agenda Item 4-B(1) and Agenda Item 4-B(2)**. It is not proposed that the Task Force Chair will walk-through these documents, rather Board members will be asked to raise any significant matters they may wish to discuss in plenary (i.e., anything further that is significant in the mapping documents). The Task Force Chair will ask for any comments of a significant nature on **Agenda Item 4-B(1)** then **Agenda Item 4-B(2)**. This will be the opportunity for Board members to raise any significant matters related to the content of the mapping documents that have not been raised in the walk-through of the draft ISA for LCE. Paragraphs 10–12 of this agenda item set out the purpose and content of the mapping documents.

## I. Introduction

### *What Have We Done Since We Last Met?*

1. The draft ISA for LCE presented in **Agenda Item 4-A** has been progressed from the initial working draft presented for discussion at the December 2020 IAASB meeting.
2. The draft ISA for LCE presented for discussion has also benefited from input from:
  - Two calls with the LCE Reference Group. Where applicable, a high level summary of the input from this group has been included in each relevant section of this Agenda Item.
  - IFAC’s Small and Medium Practices (SMP) Advisory Group. **Appendix 3** sets out a high-level overview of comments from this group.

3. Discussions in relation to the draft ISA for LCE have also taken place with:
  - IAASB Consultative Advisory Group (CAG) Representatives—the Task Force Chair will report orally at the IAASB meeting on what was heard at the March 8 CAG meeting from CAG Representatives.
  - Forum of Firms—a high level update was provided to the Forum of Firms at its February meeting.
  - Representatives from the Institute of Chartered Accountants in England and Wales (ICAEW)—matters discussed included challenges around the applicability of the standard as well as suggestions about how to make the standard more relevant to the audit of an LCE. The ICAEW representatives highlighted the importance of judgment, noted that the length of the standard does make a difference, and emphasized that the requirements do not have use exactly the same words or prescriptive processes as the ISAs.
4. The Task Force Chair and Staff also met with:
  - Staff from the International Accounting Standards Board (IASB) working on the project related to the International Financial Reporting Standard for Small and Medium Entities ([IFRS for SME](#)) to further understand the nature and scope of their current review of their standard, as well as learnings from previous reviews that may be relevant to the IAASB's development process.
  - Staff from The Institut der Wirtschaftsprüfer (IDW) in Germany, who have commenced development of a standard for auditing LCEs. The staff of the IDW shared learnings to date from their process to develop a separate standard.
  - Discussed matters that may impact the draft ISA for LCE with Staff of the ISA 600 project, including receiving an update on the progress of the revisions to ISA 600, as well as future coordination efforts with regard to developing the explanatory memorandum as it relates to group audits (see paragraph 15 below).
5. Another development that may be relevant to the Board's project is the release of an exposure draft by the Auditing and Assurance Standards Board of the Institute of Chartered Accountants in India for audits of smaller and less complex entities (out for comment until the end of March 2021). The exposure draft has not yet been analyzed by the Task Force but will be further considered as the Task Force finalizes the draft ISA for LCE for exposure.
6. **Appendix 1** sets out the members of the LCE Working Group as well as its activities. **Appendix 2** sets out the draft minutes from the December 2020 IAASB discussions.
7. The remainder of this Agenda Item sets out the significant changes made from the initial working draft presented as part of the discussion in December 2020 (initial working draft).

## II. Significant Changes Made to the Draft ISA for LCE Since December 2020

### *Name of the Standard*

8. At this stage of development of the draft separate standard, the Task Force agreed that it was appropriate to name the standard – the *International Standard on Auditing for Financial Statements of Less Complex Entities (ISA for LCE)*. This is used throughout to refer to the standard.

### General Matters

9. In the initial draft of ISA for LCE presented at the December 2020 IAASB meeting, the focus had been on including in the draft separate standard relevant requirements for an audit of less complex entities. In this draft of ISA for LCE, further changes have been made, to focus on how to articulate the requirements in context of an audit of less complex entities (where appropriate). The Task Force will continue to consider how to make the standard more relevant to audits of LCE's in the period April to June, before the exposure draft is finalized. Accordingly, Board views on the draft ISA for LCE are very important to progressing the draft to exposure draft.
10. The “mapping” documents (**Agenda Items 4-B(1) and 4-B(2)**) illustrate the International Standards on Auditing (ISA) requirements and how they have, or have not, been included within the draft ISA for LCE. In December 2020, the mapping documents broadly explained which requirements had been included, which had been changed and which had not been included – these explanations have been further advanced in this quarter.
11. The “mapping” documents presented in **Agenda Items 4-B(1) and 4-B(2)** now use ‘alignment principles’<sup>1</sup> for each requirement to help explain why an ISA requirement has not been included or changed. These alignment principles have been applied to every requirement in the ISAs and include an explanation about:
  - a) Whether the requirement is relevant in the circumstances of an audit of an LCE, and if not, why not.
  - b) If applicable, why the requirement has been changed to make it more relevant to the circumstances of an LCE.
  - c) Whether any changes made for the purpose of the ISA for LCE would still result in requirements meeting the objectives for each Part and therefore that the auditor's procedures would still enable the objectives to be met and reasonable assurance to be achieved.
12. In order to facilitate understanding how each ISA requirement is mapped to the ISA for LCE, the mapping documents are presented in ISA order in two documents (each document containing the requirements relevant to Parts 1–6 and 7–9 respectively). Therefore, to obtain a full understanding of the requirements of the ISA for LCE, the draft ISA for LCE should be read in full as that will provide the context around the requirements and how they are articulated (the requirements with the draft ISA for LCE are presented according to the flow of the audit and not by topic like the ISAs).
13. Within the draft ISA for LCE, the Task Force has also added symbols to help highlight where requirements relate to the auditor's exercise of professional skepticism, and to documentation requirements.

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<sup>1</sup> The IASB also uses principles to describe the alignment of the IFRS for SME to full IFRS. The Task Force considered the approach of using principles to describe how the ISA for LCE aligns with the ISAs helpful in describing the differences, and therefore developed the ‘alignment principles’ for this purpose.

*Comments from LCE Reference Group<sup>2</sup>*

- Many LCE Reference Group participants broadly supportive of the changes that have been made.
- Understand how still get reasonable assurance as largely based on the essential content of the ISAs which is appropriate for an audit of an LCE (not viewed as inferior).
- Keep requirements outcomes based and make it clearer what auditors required to do (modify the words while keeping the robustness of the requirements)
- Still need to consider how more can be in the draft ISA for LCE with regard to making the documentation requirements clearer (in particular in relation to the understanding of the entity and its system of internal control) – possibly simplifying for the circumstances of an audit of an LCE.
- Further consideration needed about what outreach will be undertaken to make sure that input is obtained from those jurisdictions or stakeholders who may not ordinarily comment.
- Encouragement for some field testing of the standard.
- Mixed views were expressed about the new symbols for professional skepticism and documentation that have been introduced. Some had the view that it was helpful while others did not believe it was needed in a standard and was better suited to audit software (it was noted that they are often used to replace words).
- Further consideration is needed about how an audit will transition from the IFRS for SME to a full ISA audit, and whether there are additional requirements needed to address any differences.

*Drafting Principles*

14. The focus of the revisions in this draft of the ISA for LCE have been on the appropriateness of the requirements and essential explanatory material for the circumstances of an audit of an LCE. The revisions sometimes include changes to the way that the requirements have been drafted, but there will be more focused effort in the next quarter on the drafting principles applied in this process. The Task Force is also coordinating with the Complexity, Understandability, Scalability and Proportionality (CUSP) Working Group as that group develops its drafting principles. The drafting principles developed and used for the ISA for LCE will be based on the CUSP group's principles currently being developed for drafting the ISAs, where appropriate.

*Group Audits*

15. As directed by the Board in December 2020, group audits have been excluded from the standard (this has been made clear in the applicability that if the audit engagement is an audit of group financial statements, then the standard cannot be applied). The Task Force will, however, develop a specific question on this for the explanatory memorandum that will accompany the exposure draft, including describing the impact on the standard if requirements pertaining to group audits are to be included.

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<sup>2</sup> Comments from the reference group are the views or comments from individual participants unless otherwise noted.

The Task Force will coordinate with the ISA 600 Task Force in developing the material for the explanatory memorandum.

*New Preface to the Standard*

16. The Task Force has considered how the IASB's IFRS for SME's has been presented, and made changes to the structure of the introduction of the draft ISA for LCE as appropriate. Accordingly:
- (a) A new preface has been developed to include the introductory material that does not need to be included within the standard. Changes include:
    - (i) A focus on the role of relevant authorities or bodies within each jurisdiction in relation to the use of the standard.
    - (ii) Emphasizing that an auditor may not assert compliance with the standard if it is used for entities that have not been contemplated in its design (as set out in the applicability of the standard).
    - (iii) Clearly setting out how to distinguish the requirements and the essential material (now called essential explanatory material (EEM)). All requirements are numbered (in a way that relates to the Part) and all EEM is not numbered (see paragraphs 18–18 below for more on EEM).
    - (iv) The proposed approach to maintenance of the standard. The Task Force has proposed a similar approach to the IASB for the IFRS for SMEs to maintain a 'stable platform' and only undertake a periodic revision (minimum of every 3 years, with a minimum implementation period of 18 months after date of approval of any changes).
  - (b) The applicability of the standard has been split out into its own separate Part (which forms part of the standard). Therefore, this Part of the draft ISA for LCE addresses the applicability of the standard only and sets out the prescriptive requirements for when the standard should not be used, as well as the characteristics to assist the auditor when using judgment to determine when the standard may be appropriate (or not) to the nature and circumstances of the audit engagement. A new requirement has also been added for the auditor to document their judgments in determining the appropriateness of the standard. The content of the applicability Part has also been updated to address comments received in December 2020 (see paragraphs 19–24).
  - (c) Other sections that were previously incorporated in the "Introduction" section have been moved to Part 1 of the standard – this Part is the overarching concepts and principles for the audit, and the Task Force is of the view that the sections moved are appropriately included within the standard (including in relation to the definitions, ethical requirements and quality management, and the fundamental concepts and general principles for performing an audit (the latter being presented as EEM)).

*Essential Explanatory Material*

17. EEM paragraphs are of two types:
- (a) Material that is more overarching and relevant to a sub-section—these appear under sub-headings for the related Part of the standard.

- (b) Material more directly relevant to a specific requirement. This EEM follows directly after the relevant requirement.

The Task Force had considered moving all of the EEM below a requirement but it was found that some of the EEM related to the whole sub-section and therefore it would be difficult to understand the EEM in a broader context (such EEM is of the first type explained above).

18. In the current draft of the ISA for LCE, more EEM has been added where, in the view of the Task Force, it is needed for an appropriate understanding of the requirements. However, the Task Force remains mindful of the need to maintain a balance about how much EEM is incorporated as this would add to the length of the standard. The following sets out the broad principles used for inclusion of EEM in the draft ISA for LCE:
  - (a) The EEM paragraphs do not create additional obligations for the auditor and do not include a “shall.”
  - (b) Not every concept or requirement is explained. EEM has only been provided when it is deemed to provide crucial support to the appropriate application of the concept or requirement(s).
  - (c) The EEM is not intended to provide detailed examples about “how” to apply a requirement – rather it contains descriptions of matters relevant to understanding and applying the concepts or requirements within the draft ISA for LCE. For example, it may explain more precisely what the requirement means or what the requirement is intended to cover.
  - (d) If deemed necessary, the EEM may explain “why” a procedure is required to be undertaken. It may also be used to explain the iterative nature of the standard where needed.
  - (e) The EEM, where appropriate, may illustrate how a requirement could be applied for different complexities. This illustrates scalability of the standard to the spectrum of entities that would likely fall within its remit.
  - (f) The EEM does not include background information on matters addressed in the draft ISA for LCE.

Selecting EEM paragraphs for inclusion has been based on the judgment of the Task Force, with input from the LCE Reference Group. Within the ISAs, all of the paragraphs with “considerations specific for small entities” have been considered and included as appropriate.

#### *Applicability*

19. The Task Force considered the IASB’s approach to applicability of the IFRS for SMEs, i.e., using the concept of “public accountability” to scope for which entities the standard is appropriate. The use of the concept was discussed with IASB Staff to further understand challenges and issues with using this concept. On balance, the Task Force agreed to not introduce an additional concept into the IAASB’s literature because this may cause further confusion with the concepts currently used (and also in light of the work being undertaken by the International Ethics Standards Board for Accountants (IESBA) on the definition of public interest entities (PIEs) and the impact that may have on the IAASB’s standards).
20. The Task Force has (for now) still only limited the exclusion for using the standard to listed entities (‘listed entity’ is defined) and not extended the exclusion to PIE’s. Individual jurisdictions will be able

to add further exclusions for using the standard for that particular jurisdiction (which is what has been seen with the IFRS for SMEs) – this has also been explicitly explained in the Preface. At present, there are distinct definitions of PIEs in different jurisdictions. Therefore, it is the view of the Task Force that using a concept that is not consistently applied globally may be problematic, and each jurisdiction would be able to adapt the applicability for its own circumstances. The Task Force remains mindful of the changes that may result from the IESBA PIE project and will continue to monitor those developments, and may revisit the decision to limit the exclusion to listed entities only before exposing the ISA for LCE.

21. In addition to being contained in a separate Part, the applicability of the standard has been rearticulated to contain more authority (e.g., the ISA for LCE "shall not" be used for....). As noted there has also been a specific documentation requirement added.
22. There continues to be mixed views about whether the applicability of the standard should be more prescriptive or involve more judgment. The Task Force continues to have a view that it should comprise both prescriptive matters (e.g., laws and regulations do not allow, the entity is listed, or it is an audit of group financial statements) and judgment. This is because in the view of the Task Force judgment will always be involved because the nature and circumstances of entities are all different. However, the language has been revised to be clearer and more direct, in particular in relation to the judgments that will need to be made.
23. For the December 2020 draft, in describing the characteristics of when an audit was considered to be less complex, the Task Force had described those attributes attributable to the entity itself, and those that arose because the applicable financial reporting framework resulted in complex accounting (which could impact the financial reporting in a number of ways), but the Board found this unclear. In revising the judgmental characteristics to help with the auditor's judgment about whether the standard could be used or not, the Task Force decided not to distinguish the 'types' of characteristics, but rather described them in categories which may be easier to understand. These categories include:
  - (a) The entity's business activities and governance structure.
  - (b) The entity's information system (consisting of IT systems, people involved and the processing of information).
  - (c) The entity's "basic accounting estimates" (basic accounting estimates are described in paragraphs 25–27 below).

The characteristics listed in each of the categories (and across categories) are intended to be considered individually and in combination and are subject to the auditor's judgment.

24. The prescriptive elements have also been revised, and now make it clear when the standard is not applicable. Changes made include the exclusion of audits of group financial statements (as explained above).

*Comments from LCE Reference Group<sup>3</sup>*

- Encouraged the task Force to consider how the IASB had scoped the IFRS for SME's, including considering how individual jurisdictions have made changes to the scope as needed.
- Continue to be mixed views about whether listed entities should be explicitly excluded.
- Supportive of still being able to use judgment, and important to document those judgments (supportive of documentation requirement).
- It was noted that the applicability was much clearer in the current draft.
- Further consideration needed whether to add something for those entities that are becoming more complex.
- Need to be clearer about some of the terms used, e.g., 'high-risk' so that auditor can make appropriate judgments.
- To keep in mind that basic accounting estimates can be nuanced - what is described for some as basic accounting estimates for others may be complex.

*Basic Accounting Estimates*

25. The Task Force has considered how the IASB has dealt with matters of complexity in the IFRS for SMEs, in particular how the distinction is made with regard to financial instruments. The IFRS for SMEs distinguishes 'basic financial instruments' and sets out extensive guidance about what these are. To parallel the approach of distinguishing complex from less complex, the Task Force has described the characteristics of 'basic accounting estimates' in the applicability section of the standard – i.e., the standard's requirements for accounting estimates would address these 'basic accounting estimates' but not anything with more complexity.
26. **Appendix 3** to the standard (which is new) sets out examples of what may be considered 'basic accounting estimates' for the purpose of the draft ISA for LCE. The examples are intended to help users of the standard understand what types of accounting estimates would often be associated with an entity that exhibits characteristics of being less complex (i.e., that would be included in the scope of the standard). Some of the examples provided could be considered 'basic accounting estimates,' but in other circumstances such examples could result from much more complex circumstances. The determination for using the standard will require judgment based on the circumstances, and this has been explained in the appendix.
27. The Task Force has not included considerations about the use of an auditor's expert as a distinguishing characteristic of a 'basic accounting estimate.' The decision about using an auditor's expert is a decision about 'how' to design and perform audit procedures when expertise in a field other than accounting or auditing is involved and is not about distinguishing the underlying item as complex or not. Accordingly, the Task Force does not believe that it should form part of the decision about whether the standard is applicable or not – that decision is made as the auditor is planning and

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performing the audit. By not referring to experts in the applicability Part this also alleviates the concern that the decision to use an expert will drive whether the standard is used or not.

#### *Linkage to the ISAs*

28. It has been agreed that the standard will be a standalone standard. The Task Force has further considered the linkage back to the ISAs and whether, like the IFRS for SMEs, there should be a “fallback”<sup>4</sup> (or linkage) in some cases. The Task Force considered something similar for those standards that will not be included in their entirety (i.e., ISA 701,<sup>5</sup> ISA 610 (Revised 2013)<sup>6</sup> and ISA 501<sup>7</sup> (regarding segment reporting), as the other ISAs have all been addressed as deemed appropriate to an LCE.
29. The Task Force is of the view that ISA 610 (Revised 2013) and ISA 501 (regarding segment reporting) would not be relevant in many circumstances for an audit of an LCE because the applicability would likely have scoped the entities out where these standards would likely be needed (e.g., because they are listed or have complex governance arrangements). The Task Force is also of the view that the ISA for LCE has not been designed for these circumstances and changes could be made to add requirements to these standards at a jurisdictional level if needed.
30. With regard to ISA 701 (reporting key audit matters (KAMs)), it is the view of the Task Force that there may be situations where the auditor of an LCE voluntarily reports KAMs in the auditor’s report. In such situations, a conditional requirement has been added to state that if key audit matters are reported in the auditor’s report, all of the requirements of ISA 701 will need to be complied with. Because this is a reporting standard, the use of ISA 701 does not change or impact the underlying compliance with ISA for LCE (in the same way that the IFRS for SMEs is noted as the basis of accounting even if IAS 39 requirements are used).
31. The Task Force will also still consider whether to develop a hierarchy of ‘support’ material that can be referred to by the auditor (i.e., to support implementation of the standard).

#### *Introductory Boxes*

32. The introductory boxes have been revised to make them consistent. They are now only intended to set out the content and scope of that particular Part. Where there was other material contained in the introductory boxes that was more ‘explanatory’ in nature this has been moved down into EEM within the relevant Part. The material in the introductory boxes is also not intended to create any obligations for the auditor.

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<sup>4</sup> In the IFRS for SMEs there is a “fallback” in respect of basic financial instruments, where there is a choice to either use the obligations in the IFRS for SMEs for basic financial instruments or to use the recognition and measurement principles in International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*.

<sup>5</sup> ISA 701, *Communicating Key Audit Matters in the Independent Auditor’s Report*

<sup>6</sup> ISA 610 (Revised 2013), *Using the Work of Internal Auditors*

<sup>7</sup> ISA 501, *Audit Evidence—Specific Considerations for Selected Items*

### Definitions

33. At the December Board meeting, it was highlighted that the definitions needed to form part of the ISA for LCE. The Task Force considers that adding all of the definitions to the standard would add unnecessary length to the standard but recognizes that in some jurisdictions the definitions will need to form part of the standard to be included within the standard's authority. Accordingly, the Task Force is exploring whether a more direct reference to a set of applicable definitions will "lock them in" for purposes of describing which definitions are applicable while ensuring that the definitions are only revised in accordance with due process.
34. To highlight those terms or words within the standard that have been defined in the glossary (as this will often be important context for understanding a requirement), the Task Force is exploring whether, and how, to distinguish them in some way (for example underlining all defined terms). However, if all defined terms and words are to be presented as such it would make the standard difficult to read because there are many terms and words that are defined.
35. The Task Force is therefore considering how this can be done while still making the link to the relevant definitions. In the draft ISA for LCE in **Agenda Item 4-A** this has been done for definitions contained in ISA 315 (Revised 2019), ISA 200<sup>8</sup> and ISA 220 (Revised)<sup>9</sup> on first use of a relevant defined term in each Part (as applicable). The Task Force is looking for Board views on this approach and will apply it accordingly to the other definitions. Once the ISA for LCE is moved into an electronic format, all definitions will be incorporated in the format that will clearly highlight that the word or concept is a definition (with access to the definition).

#### *Comments from LCE Reference Group<sup>10</sup>*

- Supportive of distinguishing the definitions in some way as the definition may help with understanding what is required.

### Quality Management (Part 2 of the Draft ISA for LCE)

36. Comments were received at the December 2020 Board meeting that the section on managing quality at the engagement level did not capture some of the new enhancements and changes that had been made in ISA 220 (Revised).<sup>11</sup> The requirements for quality management at the engagement level have been reconsidered and changes made accordingly, while maintaining the balance for the nature of an LCE and an LCE audit. The section has also been restructured and sub-headings inserted to try and distinguish the different types of responsibilities of the engagement partner for quality.

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<sup>8</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

<sup>9</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

<sup>10</sup> Comments from the reference group are the views or comments from individual participants unless otherwise noted.

<sup>11</sup> ISA 220 (Revised), *Quality Management for an Audit of Financial Statements*

*Communications with Management and Those Charged with Governance (First Addressed in Part 3 of the Draft ISA for LCE, as Well as Addressed Throughout the Other Parts, as Applicable)*

37. In developing the standard, it was agreed that even if an entity is an LCE, management and those charged with governance in some cases could be different, and therefore that it was necessary to maintain the communication requirements for both as done in the ISAs. It was noted (in particular by the LCE Reference Group) that in some places it was confusing in the draft ISA for LCE as to who the communication should be with.
38. Staff explored trying to distinguish the specific communication requirements between those for management and for those charged with governance. However, in doing so it either required duplication or the communications to management looked unbalanced in relation to communications with those charged with governance. Therefore, no significant changes have been made.

*Risk Identification and Assessment (Part 6 of the Draft ISA for LCE)*

39. Risk identification and assessment continues to be a painpoint in audits of LCEs. Staff further explored how to make this section more understandable for users of the ISA for LCE, while not losing the enhancements and intentions of the revisions to ISA 315 (Revised 2019).<sup>12</sup>
40. In making the changes to the requirements from ISA 315 (Revised 2019), the goal has been to rearticulate the requirements for the circumstances of an LCE audit, while retaining the robustness of the requirements so that the outcomes of the auditor's procedures using the ISA for LCE will collectively still enable the objective of the Part to be met (and therefore still contributing to reasonable assurance).
41. The objective for Part 6 (which contains the requirements for identifying and assessing the risks of material misstatement) has been revised to be clear that the objective of this Part is to identify and assess the risks of material misstatement. There is less focus in the objective on the understanding as being an outcome, but it is explained that the understanding enables the auditor to identify and assess the risks of material misstatement. In making this change, the Task Force considered that the requirements for the necessary understanding to be able to identify and assess the risks of material misstatement have collectively not been reduced, and therefore that this Part of the draft ISA for LCE has not been weakened overall by making this change to the objective.
42. There has also been a focus on the auditor's required understanding the components of the entity's system of internal control. The requirements have been rearticulated to achieve the same outcomes through explaining what the purpose of the understanding is more directly in the requirement but still requiring a similar action by the auditor as would be required in ISA 315 (Revised 2019).
43. In some cases, the work effort of the auditor in relation to obtaining the required understanding has also been described differently but the Task Force believes is still consistent with the intention of the outcome from that procedure in ISA 315 (Revised 2019).
44. Additional EEM has also been added to help with understandability of the Part.

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<sup>12</sup> ISA 315 (Revised 2019), *Identifying and Assessing Risks of Material Misstatement*

*Comments from LCE Reference Group<sup>13</sup>*

- Broadly supportive of keeping risk identification and assessment outcomes based (likes the changes that have been made) but need to consider whether more can be done as the circumstances of an LCE are relatively straightforward.
- Further consideration of whether the link between the assessed risks and the responses to the assessed risks needs to be stronger (for example through documentation requirements).
- Appendix 1 on fraud risk factors needs further consideration to make more specific for those unique circumstances that could be found in an LCE audit.

*Reporting (Part 9 of the Draft ISA for LCE)*

45. The Task Force has reconsidered whether to exclude reporting requirements from the standard and instead refer to the reporting ISAs. The Task Force continues to have the view that the standard should remain a standalone standard and therefore specific reporting requirements continue to be included in the draft ISA for LCE.
46. An example auditor's report (with a 'clean' opinion) has been presented in **Appendix 6**. The Task Force explored adding other modified reports to the draft ISA for LCE in the Appendix but this added significantly to the volume of the standard. Therefore, the Task Force is of the view that there should be an accompanying reporting 'support guide' to provide guidance and examples on modifications to the auditor's report. In addition, each jurisdiction or firms can also develop example auditor's reports as needed. It is intended that this support guide would also address changes to the auditor's report for emphasis of matter paragraphs, other matter paragraphs and the material uncertainty related to going concern paragraphs, as well as further guidance as to which reports may be appropriate in various circumstances. The Task Force will develop this support guide as part of the "package" that is exposed.
47. The Task Force has also considered the presentation of the auditor's report and how this could be made more appropriate for the circumstances of an LCE (and its expected users). Accordingly, the example report now only contains the opinion and the basis for the auditor's opinion. All other matters described in the auditor's report have been moved to the appendix to the auditor's report (with management's and the auditor's responsibilities presented first).

*Comments from LCE Reference Group<sup>14</sup>*

- Mixed views about whether to state compliance with the ISAs or the ISA for LCE.
- Support for the shorter auditor's report.
- Supportive for other examples of modified auditor's reports etc. in a support guide.

<sup>13</sup> Comments from the reference group are the views or comments from individual participants unless otherwise noted.

<sup>14</sup> Comments from the reference group are the views or comments from individual participants unless otherwise noted.

- Supportive of including a conditional requirement for key audit matters, although one questioned whether this was really needed as most LCE auditor's reports in her region would not voluntarily report KAMs.

*The Auditor's Consideration of Other Information (Addressed in Part 9 of the Draft ISA for LCE)*

48. The section on the auditor's consideration of 'other information' (i.e., relating to ISA 720 (Revised)<sup>15</sup>) has also been enhanced as it was noted that there was not enough to fully meet the intent of ISA 720 (Revised) in respect of the auditor's obligations in relation to 'other information.'

*Comparative Information (Addressed in Part 9 of the Draft ISA for LCE)*

49. Although ISA 710<sup>16</sup> applies to all engagements, because of the varied requirements around the world with respect to corresponding figures and comparative information, and the requirements within ISA 710 to accommodate the different circumstances, the Task Force has agreed that the draft ISA for LCE should include basic requirements, but not the detail. Rather, the different circumstances and how to address these should be included in a support guide for the ISA for LCE (similar to reporting explained above). The Task Force will develop this support guide as part of the "package" that is exposed.

*Appendices*

50. Various appendices have been added to the draft ISA for LCE:
- (a) Appendix 1 sets out the fraud risk factors for LCEs. The content in this appendix is from the appendix to ISA 240<sup>17</sup> relating to examples of fraud risk factors (tailored to the circumstances of an LCE). The Task Force is mindful of the current focus on fraud and how this can be perpetrated, and has therefore added this appendix. These matters also broadly cover what was heard at the Fraud Roundtable held in October 2020 (focusing on LCEs).
  - (b) Appendix 2 sets out the assertions that may be used in the audit. The content in this appendix is from the application material in ISA 315 (Revised 2019)<sup>18</sup> relating to the assertions that may be used in an ISA audit.
  - (c) Appendix 3 sets out examples of 'basic accounting estimates'—this has been further explained in paragraphs 25–27 above.
  - (d) Appendix 4 sets out an example engagement letter.
  - (e) Appendix 5 sets out an example management representation letter.
  - (f) Appendix 6 sets out a 'clean' auditor's report—this has been explained in paragraph 46 above.

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<sup>15</sup> ISA 720 (Revised), *The Auditor's Responsibilities Relating to Other Information*

<sup>16</sup> ISA 710, *Comparative Information—Corresponding Figures and Comparative Financial Information*

<sup>17</sup> ISA 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*

<sup>18</sup> ISA 315 (Revised 2019), paragraphs A189–A191

### **Matters for Board Consideration**

1. The Board is asked for comments about the requirements or other material within each Part of the draft ISA for LCE, or whether there is anything missing that would have been expected within that Part (including EEM) (some Parts also have specific questions which are detailed below):
  - (a) The Preface, as well as:
    - (i) The approach to the maintenance of the standard
  - (b) Applicability of the Standard (Part A), as well as
    - (i) The approach to describing basic accounting estimates, including the examples provided in **Appendix 3**.
  - (c) Part 1, as well as:
    - (i) The Task Force's suggested approach to presenting the definitions within the standard (the views will need to be formed based on the limited examples provided, which will then applied for all the definitions more substantially as the standard is finalized for exposure)
  - (d) Part 2.
  - (e) Part 3.
  - (f) Part 4.
  - (g) Part 5.
  - (h) Part 6.
  - (i) Part 7.
  - (j) Part 8.
  - (k) Part 9, as well as
    - (i) The approach to including ISA 701 if KAMs are voluntarily reported.
    - (ii) The example auditor's report in Appendix 6.
    - (iii) The approach to developing a support guide for reporting and comparative information.
  - (l) Appendices (to the extent not addressed in a specific Part).
2. Whether there are any significant matters in the mapping documents in **Agenda Items 4-B(1) and 4-B(2)** that have not already been addressed in the discussion of the various Parts of the draft ISA for LCE.
3. Whether there are any other matters that the Task Force should consider as the draft ISA for LCE is progressed to an exposure draft to be presented to the IAASB in June 2021, including in relation to the broad drafting of the ISA for LCE standard (i.e., what else is essential to progressing the draft for approval as an exposure draft in June 2021)?

**Task Force Members and Activities**

**Task Force Members**

1. The LCE Task Force consists of the following 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)
2. Information about the project can be found [here](#).

**Task Force Activities Since the December 2020 IAASB Meeting (Virtual)**

3. The LCE Task Force held three virtual meetings (6 videoconferences). Owing to the nature of the activities being undertaken, work was also progressed via electronic circulation of materials between members of the Task Force and IAASB staff.

## Appendix 2

### Draft Minutes from December 2020 IAASB Meeting – Audits of Less Complex Entities<sup>19</sup>

#### Project Proposal

Mr. Hagen provided the Board with an overview of **Agenda Item 2-A**, the project proposal for a project to develop a separate standard for audits of less complex entities (LCEs).

Mr. Hagen noted that a draft version of the project proposal was discussed with the IAASB CAG Representatives at a meeting in early December 2020. The IAASB CAG Representatives generally noted support for the project and emphasized the importance of the applicability (or scoping of the standard). It was encouraged that the project proposal also include that further consideration will be given to whether, and how, public interest entities are recognized in the applicability of the standard.

The IAASB was supportive of the draft project proposal and in addition to various editorial suggestions, suggested the LCE Working Group make changes to:

- Clarify how users would be impacted by a new standard.
- Emphasize the focus on the scoping to assist in understanding when the standard is appropriate to use, and clarify the role of each jurisdiction in adopting the standard.
- Make clear that the objective is to develop a standard that 'can' and 'will' be used.
- Explain that further consideration will be given to how the implementation of the standard will be supported.
- More robustly explain the link with the complexity, understandability, scalability and proportionality (CUSP) work.
- Recognize the importance of this project to the IAASB's mandate as the international auditing standard-setter.
- Recognize the impact on education, training and professional development for auditor's

#### PIOB OBSERVER'S REMARKS

Ms. Stothers emphasized the importance and urgency of project from a public interest perspective, and highlighted the need to continue to progress this project as a matter of urgency.

#### APPROVAL OF THE PROJECT PROPOSAL

After presenting an updated version of the project proposal, and discussing the final changes to be made, the IAASB unanimously approved the project proposal to revise ISA 500 with 18 affirmative votes out of the 18 IAASB members who participated in the virtual meeting.

#### Draft Separate Standard

The Board was broadly supportive of direction and many of the specific proposals of the LCE Working Group that had been presented in **Agenda Items 2 and 2-B**. However, some concern and caution was

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<sup>19</sup> These draft minutes will still be reviewed by the IAASB and may therefore change.

expressed on certain aspects, and the LCE Working Group was encouraged to further consider these matters. The Board was also very supportive of continuing to use the LCE Reference Group in an advisory capacity to further progress the draft separate standard, and noted that the comments from this group noted in the issues paper had been interesting and helpful.

With regard to the overall standard, some Board members had the view that the length was appropriate, and that it had been developed with LCE's in mind. However, some Board members encouraged that the separate standard needed to be simpler than what had been presented and noted that it needed to better focus on the lower end of complexity, while others agreed that certain aspects of areas that could become more complex should be included (as had been done in the draft presented). It was highlighted that the balance between what was in and what wasn't in should meet the needs of the stakeholders it is intended for. It was noted that a simpler standard would lead to a narrower applicability.

#### APPLICABILITY OF THE SEPARATE STANDARD

Although there was support for the approach to how the applicability had currently been described, mixed views were expressed about the applicability of the standard. Some Board members had the view that there was too much judgment involved which would result in inconsistency in its use, and questioned whether it would be consistently applied as it is currently described. Concerns were also expressed about how complexity had been described. It was acknowledged by the LCE Working Group Chair that more consideration about the scoping of the separate standard would be needed.

Some Board members had the view that something simpler was needed as complexity would be too hard to describe (and then be applied consistently), highlighting that the entry point to the standard needed to be as clear as possible. It was encouraged that the LCE Working Group further consider how the International Accounting Standards Board (IASB) describes their entry point to their standard for small- and medium-sized entities (SMEs) and whether a concept of 'public accountability,' which is what the IASB uses, would be a better entry point into the IAASB's separate standard. A few Board members also encouraged that the decision about whether the standard could be used or not be left to individual jurisdictions (i.e., law or regulation would be used to impose limitations for its use).

Further matters with regard to how complexity had been described were highlighted, including:

- That the description was too detailed and may be confusing for some.
- That further consideration of what the effect of the International Ethics Board for Accountants (IESBA's) work on "public interest entities" is needed once that work had been advanced.
- Further considering whether listed entities that were less complex could use the separate standard (although the majority of those Board members commenting on applicability agreed that listed entities should *all* be excluded).
- How the nature of the entity, and the nature of transactions, which drive complexity, was contemplated within the scoping of the standard, as this was not clear.
- That it was not clear that the applicability, as described, did not really focus on what was more "challenging" to audit.
- Comments about the specific topics highlighted in describing complexity, including the need for further consideration of the needs of individual jurisdictions and how complexity for these topics may be

different to how the topic was currently described in the applicability section of the draft (for example, retirement benefit plans in Japan).

One Board member also noted that switching to describe what was more complex may be confusing and asked that consideration be given to rather describing what was less complex.

#### STRUCTURE AND FLOW OF THE DRAFT SEPARATE STANDARD

Board members strongly supported presenting the draft separate standard using the flow of the audit. However, one Board member had the view that Section 3 on the broad concepts should be moved forward within the standard. The Board also generally gave support to keeping quality management for the audit in a separate section. Some members of the Board questioned whether the requirements relating to audit evidence more broadly were better where they are currently placed, or whether they should be moved to a later part of the standard, and questioned whether the requirements related to concluding were situated in the right place.

#### INTRODUCTORY BOXES

The LCE Task Force was encouraged to further consider the content of the introductory boxes. Although supportive of having these introductory boxes, it was noted that they were not consistent and in some cases were not that helpful. It was highlighted that the introductory boxes to Sections 4 and 5 for planning and risk identification and assessment included helpful material and the other introductory boxes should also be revised to reflect such information. It was also noted that these boxes should not contain any matters that required actions.

#### OBJECTIVES

The Board was broadly supportive of the how the objectives had been presented in the draft separate standard.

#### DEFINITIONS

There were mixed views about the current approach to referring to the definitions in the glossary. It was highlighted that the standard needed to be standalone and therefore would need to include the definitions within the standard. It was acknowledged that in a digital version this would be less of an issue.

#### USING CORE REQUIREMENTS OF THE INTERNATIONAL STANDARDS ON AUDITING (ISAs)

The Board were generally supporting of aligning the standard with the core ISA requirements that were appropriate for an LCE audit. However, there were mixed views about whether the requirements of the draft separate standard should fully align with the wording as in the ISAs, or whether they should be rearticulated as appropriate for an LCE audit. Those supporting alignment with the ISAs noted that the consistency would help avoid confusion as to what would need to be done in similar circumstances. However, it was also noted that the standard needed to be appropriate for audits of LCE's and there articulated in a way that was understandable by the audience for whom it is intended.

#### ISAs NOT ADDRESSED IN THE DRAFT SEPARATE STANDARD

The Board generally supported the ISAs that had not been included (i.e., ISA 610 (Revised 2013), parts of ISA 501 and ISA 701). One Board member asked that the LCE Task Force further consider those situations where key audit matters are voluntarily included in the auditor's report, and how this could be incorporated in the separate standard.

A few Board members also encouraged that further consideration be given to being able to refer back to the ISAs where a topic was not covered within the separate standard. However, a few Board members strongly cautioned against using parts of the ISAs when undertaking an audit using the separate standard as this would make reporting difficult and may also have other unintended consequences.

#### ESSENTIAL MATERIAL

Although supportive of a short standard, some Board members questioned the feasibility of not having more application material for implementing the standard. Other Board members were supportive of the approach as presented in the draft separate standard and noted that further consideration about an implementation guide would be needed. It was encouraged that the LCE Task Force develop an approach to what essential material is included.

One Board member noted the importance of consideration about the 'negative' requirements within the ISAs that had not been picked up in draft that was presented.

A few Board members also encouraged the LCE Task Force to consider whether to present the standard in a tabular approach.

#### GROUP AUDITS

There were mixed views about the inclusion of group audits in the scope of the separate standard. On balance and after some discussion, the Board agreed not to include group audits in the exposure draft, but rather set out the impact on the separate standard and ask for stakeholder views on this in the explanatory memorandum accompanying the exposure draft.

If group audits were to be included, there were also mixed views about a 'bright line' as the cutoff of whether a group can be audited using the separate standard or not. It was also agreed that when exploring the matter of group audits with stakeholders that questions would be included as to the appropriate scope of a group that should be included, if at all.

It was also highlighted that coordination with the Group Audits Task Force would be needed in light of the discussions about what constitutes a group.

#### USING SERVICE ORGANIZATIONS AND EXPERTS

The Board was generally supportive of including some requirements in the separate standard for service organizations.

Mixed views were expressed by Board members about whether the use of an expert should be included in the separate standard. Those supporting the exclusion of experts in the separate standard noted that if the auditor does not have the skills to audit something, then the underlying item is likely more complex and should therefore experts should not be included.

A few members did not support including either, noting that this was an example where reference back to the ISAs could be made.

#### STANDALONE STANDARD

Some Board members were supportive of a completely standalone standard, with no direct reference back to the ISAs if a matter was not covered by the separate standard. Other Board members asked that consideration be given to keeping the standard simpler and allowing reference back to the ISAs where needed. One Board member highlighted issues with reporting if the separate standard included such a reference, explaining that it would be difficult to determine compliance with a set of standards or standard in such cases.

It was also noted that it would be inappropriate to refer to the ISAs in the auditor's report for an audit using the separate standard as the ISAs would not have been fully complied with. One Board member questioned how the standalone standard would be adopted in the future if it were not more intricately linked to the ISAs (i.e., there would not be an accumulated knowledge about the ISAs if there was not such a link and an auditor did not know or use the ISAs).

#### REPORTING

Mixed views were expressed about the limited material with regard to reporting. This was one area where some members who would prefer a standalone standard noted that the ISAs could be referred to for reporting.

A few Board members noted that the requirements for reporting would need to continue to be considered as the scoping of the standard is progressed, as this would affect the reporting. It was, however, emphasized that it was important to be transparent about what standard had been used in a particular audit in the auditor's report.

#### OTHER MATTERS

A few Board members questioned whether enough had been included within the separate standard for the new requirements introduced in ISA 220 (Revised). A Board member also questioned whether there was sufficient in the standard in relation to ISA 315 (Revised 2019), in particular in relation to the entity's system of internal control. It was also noted that the scoping of the standard would impact how much was included so in some cases it may be too hard at this stage to determine whether there was sufficient in the separate standard in relation to a particular topic.

One Board member expressed concern about the content of the mapping of the ISAs to the separate standard as it may not contain enough detail as to why a particular requirement was omitted. This Board member encouraged that the LCE Task Force focus on this mapping to help Board members understand why a requirement was in or out.

#### CAG CHAIR

The CAG Chair noted support for the direction of the development of the separate standard, highlighting that many of the matters raised by Board members had been similar to the discussions at the CAG meeting. He expressed a preference for a standalone standard.

PIOB OBSERVER COMMENTS

The PIOB Observer complimented the Board on the thorough discussion on this very important public interest topic, and looked forward to further progress on the separate standard.

## Appendix 3

### Summary of Discussions with SMP Advisory Group

The LCE Task Force Chair and Staff provided an update to the SMP Advisory Group on the progress of the draft ISA for LCE to obtain input relevant to the standard.

Comments expressed by various participants noted strong support for the progress that had been made, with a few noting that the draft was easy to read and moving in the right direction for audits of LCEs. However, there was strong concerns that if audits of group financial statements were to be excluded this may inadvertently scope out many audits that would ordinarily be able to use the standard, and therefore that this may severely restrict use of the standard. It was also cautioned that the standard needed to maintain its standalone nature and not necessitate the auditor to go back to the ISAs.

#### *Applicability & Fundamental Concepts and General Principles*

Participants commented as follows:

- A questions was asked how the applicability would work in practice, in particular will it always be down to individual auditors to decide whether it is applicable and document their reasons or whether it is considered that jurisdictions would be more specific about when the standard could be used and in what circumstances.
- It was highlighted that the inclusion of audit committees as one of the characteristics of governance structures not being less complex could be reconsidered as it may lead to problems in applying the standard in certain countries.
- One participant commented that the inclusion of engagement quality reviews could imply if this was needed the entity may be sufficiently complex.
- It was highlighted whether more detail could be included in paragraph A6 to note it would be likely only be in rare circumstances that the auditor may change the determination about whether the ISA for LCE is appropriate.
- It was raised whether the content on the inherent limitations of an audit should be fully consistent with what is included in the ISAs.

#### *Definitions*

One participant noted that it would be better to include the relevant definitions within the ISA for LCE rather than refer to the ISA definitions within the glossary.

#### *Other*

Participants also commented variously as follows:

- Concern was expressed that there was insufficient material in the standard on initial engagements, and it was noted that this needed to be further explained in any guidance developed to support the standard.
- Concern was still expressed as to the extent of work with regard to the auditor's understanding of the various components of internal control, in particular in those cases where the auditor intended to undertake an audit with substantive procedures only. It was also highlighted that the risk management process in most LCE's was usually very informal but always done, and that the standard should better reflect this reality.

- There was still concern expressed as to the complexity of the risk identification and assessment process for entities that were more straightforward. It was highlighted that many LCEs do not undertake formal risk assessments.
- It was noted that there could be more emphasis in the standard on the usefulness of substantive analytical procedures as these were often a key area in audits of LCEs.
- One participant supported the material in several places which clarifies what is not required by auditors.
- It was highlighted whether slightly more detail could be needed in the application material after paragraph 6.2.1 around what is meant about obtaining evidence “outside the entity.”
- One participant supported the ‘shorter form’ of the auditor’s report presented in Appendix 6.
- Participants also questioned what the changes would be as result of using ISA for LCE, including whether audit programs would be different in practice. It was noted that the requirements are easier to understand and tailored to the entity, which should lead to higher quality audits.
- There was support for including reference to KAM (ISA 701) as it could be a possibility and further consideration may be given to including this in the standard as it is conditional.