

Audits of Less Complex Entities – Explanation of Significant Changes to the Authority (Part A), Part 6 and Part 10

This paper explains the significant changes and the rationale for the changes that have been made to following parts of the proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE):

- The Authority (Part A) – Changes are explained from the draft presented to the Board in the September 2022 meeting.
- Part 6, *Risk Identification and Assessment* – Changes are explained from the Exposure Draft (ED-ISA for LCE) except section 6.3. for which the changes are explained from the draft presented to the Board in the September 2022 meeting.
- Part 10, Audits of Group Financial Statements – Changes are explained from the draft presented to the Board in the September 2022 meeting.

The changes are reflected in the marked draft in **Agenda Item 3**, **Agenda Item 3-B** and **Agenda Item 3-F**.

Appendix 1 of this agenda item shows a mapping of the headings from ED-ISA for LCE to proposed Part 6 (**Agenda Item 3-F**).

Part A, Authority (see Agenda Item 3)

Paragraph	Significant Changes and the Rationale for Those Changes
Limitations for Using the ISA for LCE	
General	<ul style="list-style-type: none"> • The changes relating to the Limitations for Using the ISA for LCE section are explained in Agenda Item 3, paragraphs 9–14.
Qualitative Characteristics (Paragraph A.3.)	
Group Structure and Activities	<ul style="list-style-type: none"> • The Less Complex Entities (LCE) Task Force (the Task Force) removed “geographical locations” since the characteristic is addressed by the number of entities or business units (i.e., if the group has 5 or less entities or business units, they can only be at 5 or less geographical locations). • The Task Force changed the indicative number of jurisdictions to “3 or less” based on the Board comments.

Paragraph	Significant Changes and the Rationale for Those Changes
Access to Information or People	<ul style="list-style-type: none"> The Task Force changed the description to be closer to the concepts in ISA 600 (Revised).¹
Consolidation Process	<ul style="list-style-type: none"> The Task Force merged “Consolidation Process” and “Financial Reporting Process” since the consolidation process is part of the financial reporting process and changed the format to bullet points (describing examples of complexity) for readability.
Quantitative Thresholds (Paragraph A.4.)	
Paragraph A.4. and related EEM	<ul style="list-style-type: none"> The changes relating to quantitative thresholds are explained in Agenda Item 3, paragraphs 52–56.

Part 6, Risk Identification and Assessment (see Agenda Item 3-F)

Paragraph	Significant Changes and the Rationale for Those Changes
General	<ul style="list-style-type: none"> The Task Force removed the term “the entity’s internal control system” throughout as the Task Force was of the view that it is clearer to instead use “system of internal control.” This term is consistent with the defined term in ISA 315 (Revised 2019)².
General	<ul style="list-style-type: none"> The Task Force changed “understand” to “obtain an understanding” throughout as it is consistent with ISA 315 (Revised 2019) and respondents to ED-ISA for LCE (Respondents) noted that the inconsistency was confusing. This is also consistent with the Complexity, Understandability, Scalability and Proportionality Drafting Principles and Guidelines (5.1.2.).

¹ International Standard on Auditing (ISA) 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

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

Paragraph	Significant Changes and the Rationale for Those Changes
6.1. Objectives	
EEM under 6.1.1.	<ul style="list-style-type: none"> The Task Force removed the last sentence. Even though the Essential Explanatory Material (EEM) is originally from ISA 315 (Revised 2019) paragraph 7, Respondents noted the last sentence was confusing and duplicative with the sentence before, where the key concept is already addressed.
6.2. Procedures for Identifying and Assessing Risks and Related Activities	
EEM under 6.2.1.	<ul style="list-style-type: none"> The Task Force removed the final sentence of the second paragraph. Although this sentence originated from ISA 315 (Revised 2019) paragraph A22, Respondents noted it was potentially contradictory to paragraph 6.2.2 and EEM (which is clear that inspection or analytical procedures would also be required, but just not for every aspect of understanding).
EEM under 6.2.2.	<ul style="list-style-type: none"> The Task Force added EEM based on ISA 315 (Revised 2019) paragraphs A27–A29 and A32–A33 to help describe scalability considerations to address Respondents’ concerns regarding the effectiveness of risk assessment procedures in an audit of an LCE. The Task Force also added a reference to revenue accounts as described in paragraph 6.2.5.
EEM under 6.2.3.	<ul style="list-style-type: none"> The Task Force added additional EEM related to risk factors more commonly relevant to LCEs as suggested by Respondents. These additions include a reference to Appendix 3 which describes Fraud Risk Factors relevant to LCEs (in ED-ISA for LCE this was only referenced in Part 1.5).
6.2.4.	<ul style="list-style-type: none"> The Task Force made changes to better align with ISA 315 (Revised 2019) paragraph 15 and remove content relating to fraud risk factors as this is already addressed in paragraph 1.5.1.(a). Respondents noted that the original requirement was confusing.
6.2.5.	<ul style="list-style-type: none"> The Task Force removed this paragraph as paragraph 6.2.2. already requires analytical procedures to be performed and paragraph 6.4.2. already requires the auditor to consider risks of material misstatement (RoMM) related to revenue accounts. Given the expected nature of the analytical procedures that may be appropriate for a typical LCE, as well as the expected lack of complexity of revenue transactions, the additional granularity in this requirement is not proportionate for an LCE. Therefore, the Task Force decided to remove this requirement and proposes to address the benefit of analytical procedures by adding EEM under paragraphs 6.2.2. and 6.4.2., including as related to revenue accounts.

Paragraph	Significant Changes and the Rationale for Those Changes
6.3. Understanding Relevant Aspects of the Entity	
<i>Inquiries of Management and Others within the Entity</i>	
6.3.A. and 6.3.B.	<ul style="list-style-type: none"> Changed the location of requirements relating to inquiries to be earlier in the Part (i.e., as part of the understanding <u>prior</u> to identifying and assessing RoMMs).
6.3.A.(a)	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 45(b) the Task Force included inquiries relating to the entity’s risk assessment process (previously addressed in paragraph 6.3.7.) and made the inquiries more direct and proportionate to a typical LCE. The Task Force made the work effort verb an “inquiry” as this was deemed proportionate to a typical LCE and would drive the overall consideration of RoMMs and control deficiencies as described in the Part.
6.3.A.(b)	<ul style="list-style-type: none"> The Task Force moved the requirement from paragraph 6.3.2. and made the work effort verb an “inquiry” as this was deemed proportionate to a typical LCE and would drive the overall consideration of RoMMs and control deficiencies as described in the Part. The Task Force also removed reference to “or error” so as not to expand further than ISA 240.³
6.3.A. (c)	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 45(c) the Task Force included inquiries relating to the entity’s process for monitoring controls (previously paragraph 6.3.8.) and made more direct and proportionate to a typical LCE, using scalability guidance from ISA 315 (Revised 2019) (paragraphs A114 and A115). The Task Force made the work effort verb an “inquiry” as this was deemed proportionate to a typical LCE and would drive the overall consideration of RoMMs and control deficiencies as described in the Part.
6.3.A.(e)	<ul style="list-style-type: none"> The Task Force deleted the requirement to inspect correspondence as it does not relate to an inquiry (the Task Force will consider if it should be included elsewhere in the ISA for LCE).
EEM under 6.3.A.	<ul style="list-style-type: none"> The Task Force made edits for consistency with related requirements.

³ ISA 240, *The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements*, paragraph 21

Paragraph	Significant Changes and the Rationale for Those Changes
<i>Understanding the Entity and Its Environment</i>	
EEM under 6.3.1.	<ul style="list-style-type: none"> The Task Force added additional EEM as suggested by Respondents. The EEM is based on ISA 315 (Revised 2019) paragraph A68.
<i>Inherent Risk Factors (section proposed for deletion)</i>	
6.3.5.	<ul style="list-style-type: none"> Based on Respondents' comments the Task Force has removed the requirement to understand how inherent risk factors affect the susceptibility of assertions to misstatement as described in Agenda Item 3, paragraphs 35 and 46(b). Instead, these risk factors have been included in EEM as considerations when identifying and assessing risks (EEM under paragraph 6.4.1.).
<i>Understanding the Entity's System of Internal Control</i>	
EEM above 6.3.6.	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 45, the Task Force determined to apply a different approach to addressing the components of an entity's system of internal control in order to be more proportionate to the typical nature and circumstances of an LCE. As a result, there is no need to separately refer to each component individually by name.
<i>Understanding the Entity's Control Environment</i>	
6.3.6.	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 45(a), the Task Force separated out the requirement into two parts to address both the understanding and evaluation of the entity's control environment. In the September 2022 Board Meeting the Task Force had proposed to change the verb from "evaluate" to "consider". Although there was some support for such a verb change in other components of internal control, the Board's steer was to keep the work effort "evaluate" for the entity's control environment, given its foundational nature to the entity and its process to prepare financial statements. Therefore, the Task Force reverted the work effort verb in (b) to "evaluate".
EEM under 6.3.6.	<ul style="list-style-type: none"> Based on Respondent suggestions, the Task Force added additional considerations from ISA 315 (Revised 2019) paragraphs 21 and A105 as well as consideration of communication to employees (previously at paragraph 6.6.1.(d)).

Paragraph	Significant Changes and the Rationale for Those Changes
Understanding the Entity's Process to Prepare its Financial Statements	
6.3.7.	<ul style="list-style-type: none"> • Concept now addressed at 6.3.A.(a). (See comment at 6.3.A.(a) above.)
6.3.8.	<ul style="list-style-type: none"> • Concept now addressed at 6.3.A.(c). (See comment at 6.3.A.(c) above.)
6.3.9.	<ul style="list-style-type: none"> • As described in Agenda Item 3, paragraph 45(d), the Task Force updated the requirement to better focus on preparation of financial statements and re-ordered the content to match the typical logical flow of how they are addressed.
6.3.10.	<ul style="list-style-type: none"> • The Task Force deleted the requirement based on comments from Respondents. Respondents noted that in a typical LCE the communication structure would not be complex and would be appropriately covered through the understanding required at paragraph 6.3.9.
6.3.12.	<ul style="list-style-type: none"> • The Task Force deleted the specific requirement to understand controls relating to accounting estimates as the required understanding in ISA 540 (Revised)⁴ is only limited to 'identified controls' (see conforming amendments from ISA 315 (Revised 2019) to ISA 540 (Revised)). The Task Force believes that the understanding of the entity's process to prepare its financial statements (paragraph 6.3.9.) would assist the auditor identify those 'identified controls'. The Task Force is also of the view that it is not necessary to include a requirement in paragraph 6.3.14. specifically for identified controls relating to accounting estimates as they are already addressed by the categories included in paragraph 6.3.14. The Task Force has not yet performed a full review of requirements in ISA 540 (Revised) based on the discussion relating to accounting estimates in the September 2022 Board Meeting and therefore further revisions may be proposed.
6.3.13.	<ul style="list-style-type: none"> • As described in Agenda Item 3, paragraph 46(d), the Task Force deleted this requirement since it is appropriately addressed through paragraph 6.3.18.

⁴ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*, paragraph 13

Paragraph	Significant Changes and the Rationale for Those Changes
<i>Understanding the Entity's Control Activities</i>	
6.3.14.	<ul style="list-style-type: none"> Updated lead in of requirement to refer to “control activities” which is consistent with paragraph 28 of ISA 315 (Revised 2019). The Task Force had previously used only “controls”, but Respondents noted the use of different terms than in the ISA is confusing. Related EEM still refers to “controls” which is consistent with the terms use (i.e., describing the controls to be identified) in the remaining requirement.
EEM under 6.3.14.	<ul style="list-style-type: none"> Based on comments from Respondents, the Task Force added guidance from ISA 550⁵ paragraph A20. Respondents noted that more guidance in relation to related parties for LCEs would be useful.
6.3.15.	<ul style="list-style-type: none"> The Task Force merged paragraphs 6.3.15. and 6.3.16. and separated the auditor’s actions into bullets to increase readability.
<i>Deficiencies in the Entity's System of Internal Control</i>	
6.3.18.	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 46(d), the Task Force amended this requirement to also incorporate the determination of whether control deficiencies exist (previously included in paragraph 6.3.13.).
EEM under 6.3.18.	<ul style="list-style-type: none"> The Task Force added EEM regarding what the auditor may consider when deficiencies are identified. This EEM is based on ISA 315 (Revised 2019) paragraph A182, with the addition of considerations for identification and assessment of RoMMs.
6.4. Identifying and Assessing Risks of Material Misstatement	
Overall 6.4.1. and 6.5.1.	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 46(a), the Task Force combined the identification and assessment of RoMMs.

⁵ ISA 550, *Related Parties*

Paragraph	Significant Changes and the Rationale for Those Changes
6.4.2.	<ul style="list-style-type: none"> As described in Agenda Item 3, paragraph 46(c), the Task Force amended the requirement so that the auditor shall determine whether there are types of revenue, revenue transactions or assertions that give rise to a RoMM due to fraud, instead of having a presumption that there are risks of fraud in revenue recognition.
EEM under 6.4.2.	<ul style="list-style-type: none"> The Task Force added guidance to address revenue specific considerations previously addressed in paragraph 6.2.5.
6.4.3A.	<ul style="list-style-type: none"> The Task Force removed the reference to other inherent risk factors. Given the expected complexity of accounting estimates held by a typical LCE, this requirement was not deemed proportionate. The Task Force has not yet performed a full review of requirements in ISA 540 (Revised) based on the discussion relating to accounting estimates in the September 2022 Board Meeting and therefore further revisions may be proposed.
<i>Significant Risks</i>	
6.4.3D.	<ul style="list-style-type: none"> The Task Force amended this paragraph to reflect the changes made to paragraph 6.4.2. (see explanation above).
<i>Assessing Control Risk</i>	
6.4.3E.	<ul style="list-style-type: none"> The Task Force merged paragraph 6.5.3. and paragraph 6.5.8. to clarify when control risk should be assessed.
6.6. Specific Inquiries of Management and Those Charged with Governance	
6.6.1.	<ul style="list-style-type: none"> The Task Force incorporated the concept from (d) to EEM under paragraph 6.3.6. The Task Force deleted (g) as it is addressed through inquiries at paragraph 5.2.12. The Task Force furthermore noted that there is no requirement in ISA 570⁶ paragraph 10 to extend these inquiries to those charged with governance.

⁶ ISA 570, *Going Concern*

Part 10, Audits of Group Financial Statements (see Agenda Item 3-B)

Paragraph	Significant Changes and the Rationale for Those Changes
General	
General	<ul style="list-style-type: none"> • The Task Force removed content relating to component auditors throughout (distinguished through highlights). • The Task Force also removed references to the auditor “taking responsibility” because of the exclusion of component auditors from the scope of the ISA for LCE. As component auditors cannot be involved when using the ISA LCE, the auditor is solely responsible for the design and performance of procedures, tasks or actions. • The Task Force changed the reference from “group auditor” to “auditor” throughout (See Agenda Item 3, paragraph 21). • The Task Force removed footnotes referencing specific paragraphs of other Parts as the Task Force was of the view that these were not deemed necessary in ISA for LCE given that the structure of the Parts is simpler than the ISAs.
Introductory Box	
Content of this Part	<ul style="list-style-type: none"> • The Task Force deleted the second and third paragraphs as they were not considered necessary given the additions to the Authority. The Task Force was of the view that the Authority should explain when an audit is a group audit as this influences whether the ISA for LCE can be used. • The Task Force deleted the last paragraph as it is referring to requirements and EEM that deal with the situation when component auditors are involved.
10.4. Understanding the Group and Its Environment, the Applicable Financial Reporting Framework and the Group’s System of Internal Control	
10.4.1.	<ul style="list-style-type: none"> • Based on comments from the Board at September 2022 Board Meeting, the Task Force added special considerations in this requirement. In determining which matters to bring in, the Task Force reviewed which of the special considerations in ISA 600 (Revised), paragraph 30 would apply to a LCE that is a group and whether these special considerations are not addressed elsewhere in the ISA for LCE. The Task Force added: <ul style="list-style-type: none"> ○ The locations in which the group has its operations or activities and the extent to which they are similar across the group;

Paragraph	Significant Changes and the Rationale for Those Changes
	<ul style="list-style-type: none"> ○ The nature and extent of commonality of controls; and ○ How the group centralizes activities relevant to financial reporting.
10.7. Specific Communication Requirements	
10.7.	<ul style="list-style-type: none"> • The Task Force deleted the table and instead included the requirements in a written format with separate requirements for communication with group management and those charged with governance of the group. After the removal of component auditor requirements, the Task Force did not believe the use of a table was necessary given the number of remaining communication requirements.

Appendix 1

Part 6 Risk Identification and Assessment – Mapping of Proposed Structural Changes

This appendix shows a mapping of the headings from ED-ISA for LCE to proposed Part 6 (**Agenda Item 3-F**). Headings that have remained the same are shown in green, those which have moved or renumbered are shown in blue, and those that are new or deleted are shown in orange.

Exposure Draft (ED-ISA for LCE)	Revised Part 6 (Agenda Item 3-F)	Explanation
6.1. Objectives (6.1.1.)	6.1. Objectives (6.1.1.)	–
6.2. Procedures for Identifying and Assessing Risks and Related Activities (6.2.1.–6.2.6.)	6.2. Procedures for Identifying and Assessing Risks and Related Activities (6.2.1.–6.2.6.)	–
6.3. Understanding Relevant Aspects of the Entity	6.3. Understanding Relevant Aspects of the Entity	See detail below
–	<i>Inquiries of Management and Others within the Entity (6.3.A.–6.3.B.)</i>	Moved inquiries from Part 6.6.
<i>Understanding the Entity and Its Environment (6.3.1.–6.3.2.)</i>	<i>Understanding the Entity and Its Environment (6.3.1.)</i>	–
<i>Understanding the Applicable Financial Reporting Framework (6.3.3.–6.3.4.)</i>	<i>Understanding the Applicable Financial Reporting Framework (6.3.3.–6.3.4.)</i>	–
<i>Inherent Risk Factors (6.3.5.)</i>	–	Removed
<i>Understanding the Entity's Internal Control System (6.3.6.–6.3.17.)</i>	<i>Understanding the Entity's System of Internal Control</i>	-
–	Understanding the Entity's Control Environment (6.3.6.)	New Sub-heading

Audits of Less Complex Entities – Explanation of Significant Changes to the Authority (Part A), Part 6 and Part 10
IAASB Main Agenda (December 2022)

–	Understanding the Entity’s Process to Prepare its Financial Statements (6.3.9., 6.3.12., 6.3.12A.)	New Sub-heading
–	Understanding the Services Provided by a Service Organization (6.3.12B.)	New Sub-heading
–	Understanding the Entity’s Control Activities (6.3.14.–6.3.15.)	New Sub-heading
<i>Deficiencies in the Entity’s Internal Control System (6.3.18.)</i>	<i>Deficiencies in the Entity’s System of Internal Control (6.3.18.)</i>	
6.4. Identifying Risks of Material Misstatement (6.4.1.–6.4.3.)	6.4 Identifying and Assessing Risks of Material Misstatement	Combination of 6.4. and 6.5. requirements
–	<i>No subheading (6.4.1–6.4.3A.)</i>	-
–	<i>Significant Risks (6.4.3B.–6.4.3D.)</i>	Moved from 6.5.
–	<i>Assessing Control Risk (6.4.3E.)</i>	Moved from 6.5.
–	<i>Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Revision of Risk Assessment (6.4.3F.–6.4.3G.)</i>	Moved from 6.5.
6.5. Risk Assessment	–	Combined with 6.4.
<i>Assessing Inherent Risk (6.5.1.–6.5.3.)</i>	–	Separate header longer needed
<i>Significant Risks (6.5.4.–6.5.7.)</i>	–	Moved up to 6.4.
<i>Assessing Control Risk (6.5.8.)</i>	–	Moved up to 6.4.

Audits of Less Complex Entities – Explanation of Significant Changes to the Authority (Part A), Part 6 and Part 10
IAASB Main Agenda (December 2022)

<i>Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Revision of Risk Assessment (6.5.9.–6.5.10.)</i>	–	Moved up to 6.4.
<i>Evaluation of the Appropriateness of Using the [draft] ISA for LCE (6.5.11.)</i>	6.5 Evaluation of the Appropriateness of Using the ISA for LCE (6.5.A.)	Made own header as did not fall under 6.4.
6.6. Specific Inquiries of Management and Those Charged with Governance (6.6.1.–6.6.2.)	–	Moved Inquiries to 6.3.A.
6.7. Specific Communication Requirements (6.7.1.)	6.7. Specific Communication Requirements (6.7.1.)	–
6.8. Specific Documentation Requirements (6.8.1.–6.8.2.)	6.8. Specific Documentation Requirements (6.8.1.–6.8.2.)	–