

Audits of Less Complex Entities – Selected Issues

Objectives of the Board Discussion

The objectives of this session are to:

- a) Approve the Exposure Draft of Part 10, *Audits of Group Financial Statements*, and related conforming amendments to other parts of the proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE) for public consultation.
- b) Obtain the Board's input on:
 - Part 6, *Risk Identification and Assessment*;
 - Quantitative threshold section in the Authority; and
 - Views and recommendations on the way forward in relation to selected other topics.

Board Discussion

Issues Paper

This paper describes the issues addressed by the Less Complex Entities (LCE) Task Force (the Task Force) and for discussion with the IAASB at its December 2022 meeting.

The following appendices to this Agenda Item have been presented:

Appendix 1	Task Force Members and Activities
Appendix 2	Reconciliation of ED-ISA for LCE Question Analysis
Appendix 3	Approach for the Discussion of Part 6, <i>Risk Identification and Assessment</i>

In addition to this issues paper, the following agenda items have been presented:

Agenda Item 3-A	Explanation of Significant Changes to the Authority (Part A), Part 6 and Part 10
Agenda Item 3-B	Proposed Part 10, <i>Audits of Group Financial Statements</i> – Marked
Agenda Item 3-C	Proposed Part 10, <i>Audits of Group Financial Statements</i> – Clean
Agenda Item 3-D	Proposed Conforming Amendments Resulting from Part 10
Agenda Item 3-E	Proposed Part 6, <i>Risk Identification and Assessment</i> – Clean
Agenda Item 3-F	Proposed Part 6, <i>Risk Identification and Assessment</i> – Marked

Supplement 1	NVivo Respondent Summary Analysis for Selected Questions from ED-ISA for LCE
Supplements 1-01 – 1-03	NVivo Reports with Respondents' Comments on Selected Questions from ED-ISA for LCE

Introduction

What Have We Done Since We Last Met?

- Appendix 1** sets out the members of the Task Force, as well as its activities.
- Following direction provided by the Board in the September 2022 IAASB meeting ([see draft minutes](#)), the Task Force progressed the drafting in targeted areas of the proposed ISA for LCE:
 - Targeted revisions to the Authority (Part A) of the proposed standard relating to audits of group financial statements and quantitative thresholds;
 - Part 10, *Audits of Group Financial Statements*; and
 - Part 6, *Risk Identification and Assessment*.
- The Task Force also continued to analyze responses to the [Exposure Draft](#) of the ISA for LCE (ED-ISA for LCE). A reconciliation of the questions for respondents of ED-ISA for LCE (“respondents”), along with the date discussed or the expected date to be presented to the Board for discussion is described in **Appendix 2**.
- This agenda item summarizes the matters described in paragraphs 1–3.

Liaison with Other IAASB Task Forces

- The Task Force Chair and Staff met with the Task Force Chair and Staff of the IAASB’s project on the definitions of listed entities and public interest entities. Among other matters, they discussed the potential adoption of the revised definitions in the IAASB’s standards and the related differential requirements for certain types of entities. Staff supporting both projects, and the respective Task Force Chairs, will continue to liaise after the December 2022 Board meeting.
- Staff also met with Staff supporting the IAASB’s project relating to Going Concern to discuss the proposed revisions to ISA 570 (Revised)¹ as relevant to LCEs and the proposed ISA for LCE.
- As the LCE project continues to progress and further revisions are proposed, Staff supporting the LCE project will consider liaising with other task forces, working groups and consultations groups (including the Fraud Task Force and Technology Consultation Group) as appropriate.

¹ International Standard on Auditing (ISA) 570 (Revised), *Going Concern*

I. Group Audits

Background

8. Based on the comments received during the September 2022 Board meeting, the Task Force updated Part 10 of the proposed ISA for LCE and the Authority as it relates to group audits. The Task Force also made conforming amendments to other Parts of the proposed ISA for LCE (reflecting the proposed incorporation of Part 10).

Authority

Qualitative Characteristics

9. In the September 2022 Board Meeting, the Board commented on the proposed qualitative characteristics related to group audits. The Task Force considered the comments and proposed revisions to the qualitative characteristics described in paragraph A.3. in the Authority. See **Agenda Item 3-A** for a description of the changes.
10. Please refer to “Proposed Revisions” under paragraph 14 below for the proposed changes made to the Authority.

Component Auditors

11. In the September 2022 Board Meeting, the Board supported excluding from the scope of the proposed ISA for LCE group audits in which component auditors are involved. The Board also directed the Task Force to define “component auditor” in the Authority and to provide sufficient guidance around evaluating whether an auditor is a component auditor or not. Based on that discussion, the Task Force decided to add Essential Explanatory Material (EEM) under paragraph A.1. in the Authority to describe a component auditor. This description is based on the related definitions in ISA 600 (Revised).²
12. The Task Force also considered whether ISA for LCE could go “beyond” what is defined in ISA 600 (Revised), for example by providing an exception to use an auditor other than the group auditor to perform only limited activities such as an inventory count or physical asset verification at a component. The Task Force concluded that this would create inconsistency with the definitions used in ISA 600 (Revised) and may cause confusion about the scope of the proposed ISA for LCE and potential scope creep of what may constitute “limited activities”. The Task Force also considered that the number of instances where this would happen in an audit of a less complex group (based on the characteristics in the Authority) would not be frequent. To ensure clarity in understanding the Authority and its limitations for using the proposed ISA for LCE, the Task Force propose to not pursue the introduction of any exceptions.
13. The Task Force also proposes to add EEM based on paragraphs A4 and A5 in ISA 600 (Revised). These paragraphs were deemed critical in determining whether the audit is a group audit. To clarify that a group auditor may perform procedures on components and will not be considered a component auditor, EEM was added based on ISA 600 (Revised) paragraph A22.

² ISA 600 (Revised), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

Proposed Revisions

14. The proposed revisions to the Authority presented below are tracked from the version presented at the September 2022 Board Meeting:

A. Authority of the ISA for Audits of Financial Statements of Less Complex Entities

Content of this Part

...

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).³

...

Limitations for Using the ISA for LCE

...

Specific Prohibitions

...

A.1. The ISA for LCE shall not be used if:

...

(d) The audit is an audit of group financial statements (group audit) and:

(i) Any of the group’s individual entities ~~or~~ and business units meets the criteria as described in paragraph A.1.(b) or A.1.(c); or

(ii) ~~{Component auditors are involved.}~~

A single legal entity may be organized with more than one business unit, for example, a company with operations in multiple locations, such as a store with multiple branches. When those business units have characteristics such as separate locations, separate management, separate general ledger and the financial information is aggregated in preparing the single legal entity’s financial statements, such financial statements meet the

³ As defined in **Appendix 1**, A “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. The term “consolidation process” as used in the ISA for LCE is not intended to have the same meaning as “consolidation” or “consolidated financial statements” as defined or described in financial reporting frameworks. Rather, the term “consolidation process” refers more broadly to the process used to prepare group financial statements. 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. The Glossary (**Appendix 1**) describes the meanings attributed to certain terms for the purpose of the ISA for LCE, including the meaning of group and group financial statements.

definition of group financial statements because they include the financial information of more than one entity or business unit through a consolidation process.

In some cases, a single legal entity may configure its information system to capture financial information for more than one product or service line for legal or regulatory reporting or other management purposes. In these circumstances, the entity’s financial statements are not group financial statements because there is no aggregation of the financial information of more than one entity or business unit through a consolidation process. Further, capturing separate information (e.g., in a sub-ledger) for legal or regulatory reporting or other management purposes does not create separate entities or business units (e.g., divisions) for purposes of this ISA for LCE.

Component Auditors

A component auditor is an auditor who performs audit work related to a component⁴ for purposes of the group audit. A component auditor is a part of the engagement team for a group audit. When the auditor responsible for the group audit performs audit procedures related to a component, the auditor is not considered a component auditor.

...

Qualitative Characteristics

...

A.3. ...

For the purpose of group audits of group financial statements, these considerations shall apply to both the group and each of its individual entities and business units.

...

Additional Characteristics Relevant for <u>Group Audits of Group Financial Statements</u>	
<i>For <u>group audits of group financial statements</u>, the following qualitative characteristics are to be considered in addition to those above:</i>	
Group Structure and Activities	The group has few entities or business units (e.g., 5 or less). Group entities or business units are limited to few jurisdictions or geographical locations (e.g., <u>5</u> or less).
Access to Information or People	Management can provide access to all information and people within the group relevant to the preparation of the group financial statements. <u>Group management will be able to provide the engagement team with access to information and unrestricted access to persons within the group as determined necessary by the auditor.</u>

⁴ A component is an entity, business unit, function or business activity, or some combination thereof, determined by the auditor responsible for the group audit for the purposes of planning and performing audit procedures in a group audit.

<p>Consolidation Process Financial Reporting Process</p>	<p>The group has a simple consolidation process. <u>For example: (e.g., no complex sub-consolidations, simple aggregation/ consolidation adjustments, non-complex intercompany transactions).</u></p> <ul style="list-style-type: none"> • Financial information of all entities or business units have been prepared in accordance with the same accounting policies applied to the group financial statements; • All entities or business units have the same financial reporting period-end as that used for group financial reporting; • <u>There are no sub-consolidations; and</u> • <u>There are no complex intercompany or other consolidation adjustments.</u>
...	

Part 10, Audits of Group Financial Statements

Requirements

15. The Task Force removed all requirements related to the involvement of component auditors, considering the direction from the Board in the September 2022 meeting to exclude the use of component auditors from the scope of the proposed ISA for LCE.
16. The Task Force also considered the suggestions provided by the Board in the September 2022 meeting and proposed changes to the other content of Part 10. Please refer to **Agenda Item 3-B** for the proposed changes made to Part 10 and **Agenda Item 3-A** for the explanation on the changes made to Part 10.

Essential Explanatory Material

17. The draft of Part 10 as presented to the Board in the September 2022 meeting contained limited EEM. The Task Force reviewed the application material included in ISA 600 (Revised) and included EEM when it was deemed to be appropriate and proportionate for a typical LCE and consistent with the general approach to EEM taken in the proposed ISA for LCE. Paragraph 88 of the [Explanatory Memorandum accompanying ED-ISA for LCE](#) (the EM), explains that the EEM serves a similar purpose to application and other explanatory material in the ISAs, but is much more limited than what is presented within the ISAs and is targeted at a higher level.

Conforming Amendments to Other Parts Due to Part 10

18. The Task Force reviewed Parts 1–9 of the proposed ISA for LCE to identify areas where conforming amendments should be made due to the incorporation of group audits and identified conforming amendments to the Authority, Preface, Part 9, *Forming an Opinion and Reporting*, and the Glossary.

Please refer to **Agenda Item 3-D** for the proposed amendments. Conforming amendments have been tracked from the ED-ISA for LCE.

19. The conforming amendments to the Authority due to Part 10 are discussed in paragraphs 9–14 above. Revisions to the Authority of the proposed ISA for LCE will not be shown as a conforming amendment in the exposure draft, but instead will be presented and described in the explanatory memorandum that will accompany the exposure draft. The main reason for this is that significant changes have been made to the content and presentation of the Authority (responding to the comments received on the ED-ISA for LCE) so tracking it from the ED-ISA for LCE may lead to confusion and may result in irrelevant comments (i.e., comments not related to the inclusion of group audits). The explanatory memorandum will include a discussion of directional changes to the Authority that have been discussed by the Board since the exposure draft (e.g., changing approach to describe what is less complex rather than more complex) alongside a table of additional qualitative characteristics for group audits and any other group audit specific content.
20. In the Preface, the Task Force added an overarching provision explaining that in a group audit, all the relevant requirements of the other Parts apply. This has been proposed in the Preface at paragraph P.12. under “Format of the ISA for LCE”.
21. In the Glossary, the Task Force added definitions for terms used in Part 10. These definitions are similar to the definitions in ISA 600 (Revised). The Task Force decided not to include the following definitions from ISA 600 (Revised):
 - Group auditor. ISA 600 (Revised) describes requirements of both the group auditor and component auditor. As component auditors are not in the scope of the proposed ISA for LCE, auditors using the proposed ISA for LCE can only be a group auditor (ISA 600 (Revised) only refers to the group auditor or a component auditor). Therefore, the Task Force concluded that it is not necessary to use the term “group” when referring to the auditor. This also aids in the consistency of Part 10 with the other Parts.
 - Group audit opinion. As there are no references to the group audit opinion in Part 10, the Task Force did not include this definition
 - Group engagement partner. As there are no references to the group engagement partner in Part 10, the Task Force did not include this definition.
22. In Part 9 a footnote explains the additional content of the Auditor’s Report in case of a group audit. In addition, it is anticipated that the Supplemental Guide on Reporting will be updated for matters relevant for group audits (including illustrative reports) after finalization of the proposed ISA for LCE. This will also be communicated in the explanatory memorandum.

Approval of Exposure Draft

Exposure Period

23. The Task Force aims to publish the exposure draft of Part 10, *Audits of Group Financial Statements* in mid-January 2023 with a 90-day comment period. Based on this expected timing, responses would be due by mid-April 2023. This comment period will allow the Task Force to present feedback received and initial proposed revisions of Part 10 at the September 2023 IAASB meeting and would allow,

subject to the nature and extent of comments received, the Board to approve the revised Part 10 at the same time as the remaining parts of the proposed ISA for LCE (i.e., December 2023).

24. This proposed timeline includes an exposure period less than the 120-day period ordinarily noted in the IAASB's due process.⁵ However, given the length and concise nature of Part 10, the Task Force believes this is appropriate.

Effective Date

25. The Task Force is of the view that the effective date of Part 10 should be the same as for the proposed ISA for LCE. This will be explained in the explanatory memorandum and the Task Force believes there is no need to ask any specific question about the effective date as part of the exposure draft.

Content of the Explanatory Memorandum

26. The Task Force propose to describe the following significant matters in the Explanatory Memorandum that will accompany the exposure draft:
- (a) Background to the Boards decision to include group audits in the scope of the proposed ISA for LCE based on comments received from respondents to ED-ISA for LCE.
 - (b) Extracts from the draft Authority relating specifically to group audits in order for respondents to be able to understand the proposed scope of group audits for which the use of the proposed ISA for LCE is appropriate. Including, as described in paragraph 19, a high-level overview of the directional changes that the Board has discussed regarding the Authority of the proposed ISA for LCE more broadly (i.e., to give sufficient context for respondents).
 - (c) Key considerations in developing the content of Part 10.
27. The Task Force intend to ask for respondents' views on:
- (a) The content of proposed Part 10 and related conforming amendments; and
 - (b) The proposed scope of group audits for which the proposed ISA for LCE may be used.

Due Process Matters

28. In the Task Force's view, the significant matters identified as a result of its deliberations about group audits in the proposed ISA for LCE have been presented in the issues papers presented to the Board for discussion. This includes the position on group audits that was presented in ED-ISA for LCE and the further deliberations about group audits in response to the feedback received on ED-ISA for LCE. In the Task Force's view, there are no significant matters that have not been brought to the attention of the IAASB.
29. The Task Force does not believe that a consultation paper, field testing or a roundtable is needed at this stage of the project.

⁵ The IAASB's due process requires that an ED ordinarily has a 120-day comment period.

Matters for Board Consideration

Authority

1. The Board is asked for their views on the changes made to the Authority related to group audits as set out in paragraph 14.

Content of Part 10

2. The Board is asked for their views on the changes made to the requirements and EEM in Part 10 as set out in **Agenda Item 3-B**. The Board will be asked to provide feedback in the following order:
 - (a) Content of this Part, Sections 10.1–10.4
 - (b) Sections 10.5–10.8

Conforming Amendments to Other Parts Due to Part 10

3. The Board is asked for their views on the proposed changes to Parts 1–9 in **Agenda Item 3-D**, including if there is anything else to add.

Approval of Exposure Draft

4. The Board is asked if they have any comments regarding the proposed exposure period, effective date and content of the explanatory memorandum, or further comments regarding Part 10 and related conforming amendments.
5. The Board is asked to approve proposed *Part 10, Audits of Group Financial Statements*, and related conforming amendments for public exposure.

II. Part 6 – Risk Identification and Assessment

Background

30. In the September 2022 Board Meeting the Board provided feedback on some illustrative drafting and generally agreed with an approach to requirements or parts of requirements being moved, presented as EEM or removed where appropriate. The Board had mixed views regarding changes to verbs that determine the work-effort (e.g., “evaluate” to “consider”).

Additional Analysis of Respondent Comments on Part 6

31. In addition to the questions in the EM that were presented to the Board in June 2022 (and that included comments related to Part 6), respondents also provided feedback on Part 6 of ED-ISA for LCE as part of:
 - Question 9: *Please provide your views on the content of each of Parts 1 through 8 of ED-ISA for LCE, including the completeness of each part. In responding to this question, please distinguish your comments by using a subheading for each of the Parts of the proposed standard.* Comments on Part 6 are reflected in **Supplements 1 and 1-01**.
 - Question 12: *Are there any areas within Parts 1–9 of the proposed standard where, in your view, the standard can be improved? If so, provide your reasons and describe any such*

improvements. It will be helpful if you clearly indicate the specific Part(s) which your comments relate to. Comments on Part 6 were “mapped” to Q9 and are reflected per above.

32. Detailed comments relating to Part 6 provided in other questions have also been mapped to question 9 in NVivo and are reflected in **Supplements 1 and 1-01**. A summary has been included in paragraphs 33–43 below.

What We Heard – Detailed Respondent Comments on Part 6

Proportionality to an Audit of an LCE

33. Respondents noted that Part 6 could be more streamlined and “scalable” (proportionate) to audits of LCEs while still achieving the outcomes to obtain reasonable assurance and not compromise audit quality. In particular, respondents noted that the entity’s system of internal control is generally straightforward and less formalized in an LCE and that some requirements in Part 6 would not be relevant for a typical LCE. It was specifically noted that even where requirements may be relevant, the proposed level of granularity would be overly onerous (i.e., not proportionate) and would not have any impact on the risk assessment and design of audit procedures to be performed (i.e., would be a “box-ticking exercise” only).
34. In addition, respondents questioned if a required understanding and separate evaluation of each of the five components of internal control was appropriately proportionate to the typical nature and circumstances of an audit of an LCE. They suggested that the requirements could be at a higher level, taking into account what the auditors’ objective is in obtaining an understanding of the entity’s internal control system is (i.e., to provide a basis to identify and assess risks of material misstatement and to design further audit procedures). In particular, respondents noted that detailed consideration of the entity’s risk assessment process and process for monitoring of controls may not be relevant given the likelihood that an LCE would not have formalized or documented controls in these areas. Respondents also noted that in an audit of an LCE there is no need for certain aspects of an entity’s system of internal control to be ‘evaluated’, but rather they should be ‘considered’, for example by means of inquiry.

Identification and Assessment of Risks of Material Misstatement

35. Respondents noted that granularity of requirements relating to the identification and assessment of risks of material misstatement is unnecessarily complex for an LCE. For example, respondents questioned if it was necessary to require the understanding of (and therefore documentation of) how inherent risk factors affect the susceptibility of assertions to misstatements and the degree that they do so, given risks are expected to be less complex or the process to identify or assess risks is expected to be less complex. Respondents also questioned whether it was necessary to separately identify and assess risks when it was commonly performed in one step in an audit of an LCE (while still achieving the outcome of assessed risks at the assertion level that appropriately focus the auditor’s work effort in designing and performing further audit procedures).

Nature and Extent of Risk Assessment Procedures

36. Respondents questioned if a requirement to perform all the procedures in paragraph 6.2.2. of ED-ISA for LCE (i.e., inquiry, analytical procedures, inspection and observation) was appropriate for every audit. In particular, respondents questioned if it was always necessary to perform analytical

procedures as a risk assessment procedure in an audit of an LCE, noting that it may be ineffective where the entity’s preliminary financial information requires year-end adjustments (e.g., cut-off adjustments, amortization, etc.) to be comparable.

37. Respondents also questioned if observation and inspection would always be required as LCEs may not have established structured processes and systems, or may have established processes or systems with limited documentation, or a lack of consistency in how they are undertaken. Respondents suggested more flexibility, for example by allowing auditors to choose the combination of procedures that would be appropriate based on the facts and circumstances.

Conditionality

38. Respondents questioned if more conditionality could be built into the requirements in Part 6 (i.e., to be clearer that requirements would only need to be addressed (and documented) where they would be relevant) to make the standard more scalable. It was noted that the standard would be applicable for both very simple LCEs, who may lack the resources to have any formalized or robust controls, and LCEs where a more formal system of internal control is in place.
39. Respondents also noted that in an audit of a typical LCE auditors generally take a fully substantive approach, particularly when an auditor already understands there are few formalized controls that could be reliably tested. It was noted that in this instance evaluating all the components of an entity’s system of internal control, in particular the evaluation of the design and implementation of identified control activities, did not add “value” to the audit. For example, when the auditor has assessed the control risk as high, such procedures rarely impacted the identification and assessment of risks of material misstatement or the design of further audit procedures. Therefore, respondents suggested that conditionality could be built in when an auditor already intends to take a fully substantive approach, for example, by not requiring the auditor to obtain evidence about the design and implementation of identified controls, or by allowing inquiry alone to be sufficient to gain an appropriate understanding of the entity’s system of internal control (i.e., rather than inspection or observation in addition).

Requirements Relating to Fraud

40. Respondents challenged the presumption that there are risks of fraud in revenue recognition, or that fraud risks should be presumed to be a significant risk, noting that it would be unlikely for an LCE to have complexity in this area and that the documentation to support a rebuttal is generally onerous and not proportionate for LCEs.
41. Respondents also questioned if the granularity of inquiries required with management were necessary given that management of LCEs are less likely to be making fraud assessments, determining responses and making communications regarding fraud and it was difficult to document inquiries where formal processes do not exist.

Other Themes

42. Respondents suggested that further EEM may be appropriate, either in specific targeted areas or more generally in the Part. It was suggested to add EEM specific to LCEs and their circumstances, for example in relation to the risk of management override in an owner-managed entity or relating to risks from closely held ownership structures and related parties.

43. Respondents noted that the inclusion (as EEM) of application material from ISA 315 (Revised 2019)⁶ relating to scalability was useful, but noted that, as the proposed standard is designed specifically for LCEs and so does not need to address matters for complex entities, it would be more effective to revise requirements where appropriate (i.e., rather than just reflecting scalability considerations in EEM).

The Task Force Views and Recommendations

44. Based on input from the June and September 2022 Board meetings and the detailed analysis of respondent comments, the Task Force proposes revisions to Part 6. Please refer to **Agenda Item 3-F** for the proposed changes and **Agenda Item 3-A** for a description of the significant changes.
45. Taking into account respondents' comments and the key objective to be more proportionate to an LCE while still obtaining reasonable assurance, the Task Force proposes to have a more LCE specific approach for obtaining an understanding of the entity's system of internal control. The Task Force proposes the following key changes from the ED-ISA for LCE:
- (a) *Entity's Control Environment* – Given its fundamental importance, the requirement includes both an understanding of the control environment and evaluation of its appropriateness as a foundation for the entity's system of internal control (paragraph 6.3.6.).
 - (b) *Entity's Risk Assessment Process* – Included as part of inquiries with management and re-worded to be more direct and appropriate for a typical LCE (paragraph 6.3.A.(a)).
 - (c) *Entity's Process for Monitoring Controls* – Included as part of inquiries with management and re-worded to be more direct and appropriate for a typical LCE (paragraph 6.3.A.(c)).
 - (d) *Entity's Information System* – The requirements have been updated to be more direct and focus on the entity's process to prepare its financial statements, including a consideration⁷ for whether the entity's process appropriately supports the preparation of financial statements in accordance with the applicable financial reporting framework (paragraphs 6.3.9. and 6.3.12A.).
 - (e) *Entity's Control Activities* – approach consistent with ED-ISA for LCE but streamlined for readability (paragraphs 6.3.14. and 6.3.15.).
46. In response to respondents' comments to be more proportionate to an LCE while still achieving reasonable assurance, the Task Force also proposes the following key changes from the ED-ISA for LCE:
- (a) *Combination of Risk Identification and Assessment* – Based on respondents' comments that this is normally performed in one step in an audit of an LCE and that the different layers of decision making is unnecessarily complicated, these areas have been combined (paragraph

⁶ ISA 315 (Revised 2019), *Identifying and Assessing the Risks of Material Misstatement*

⁷ For the September 2022 Board meeting, the Task Force proposed to change the work effort verb from 'evaluate' to 'consider.' The Board had mixed views on whether work-effort verbs should be changed for all relevant components of internal control. Some were of the view that the work effort verb should be the same as in ISA 315 (Revised 2019) while others supported the change of the work effort verb in this area given the expected complexity of the process to prepare the financial statements in a typical LCE. The Task Force continues to believe that "consider" is appropriate based on the work effort as described in the Complexity, Understandability, Scalability and Proportionality Drafting Principles and Guidelines.

6.4.1. and 6.5.1.).

- (b) *Requirement to Explicitly Understand Effect of Inherent Risk Factors* (previously paragraph 6.3.5.) –Taking into account respondents’ comments that this step rarely adds any incremental value in the circumstances of a typical LCE, this has been removed and instead the concepts are included in EEM as considerations when assessing risks. The Task Force will further consider what supplemental or implementation guide may be needed to support these considerations. (EEM under paragraph 6.4.1.).
 - (c) *Presumption of Revenue Recognition Fraud Risk* – considering respondents’ comments that the presumption that there are risks of fraud in revenue recognition may not always be appropriate for an LCE, the requirement has been revised to instead require an active determination of potential fraud risks resulting from types of revenue, revenue transactions or assertions (paragraph 6.4.2.).
 - (d) *Other Revisions for Proportionality* – the Task Force performed a general review of other requirements identified by respondents as being too granular or duplicative of other requirements and proposed edits. For example, requirements from throughout the Part relating to control deficiencies have been combined into one requirement (paragraph 6.3.18.).
47. To address comments from respondents to ED-ISA for LCE, the Task Force added EEM, or clarified existing EEM, in several areas, in particular to describe how requirements may be applied in a typical LCE. The Task Force has the view that, although the volume of EEM may be greater than in other parts of the proposed ISA for LCE, it is appropriate as risk identification and assessment was identified as a pain point by respondents and is fundamental to an audit. The approach of adding further EEM in targeted areas identified by respondents is consistent with the approach described in paragraphs 67–68 below.
48. The Task Force did consider respondents’ views about whether all risk assessment procedures would be required (see paragraphs 36–37 above) in every audit and concluded that they should be. To address respondent concerns, the Task Force proposes to include more EEM regarding scalability.
49. The Task Force also considered whether requirements such as those when evaluating the design and implementation of identified controls should be different if a fully substantive approach should be taken (see paragraph 39 above) and concluded it should not be, particularly when considering the extent of identified controls required in ISA 315 (Revised 2019).
50. While the Task Force proposes some revisions to requirements relating to accounting estimates, a full review of requirements in ISA 540⁸ (based on the proposed approach to accounting estimates discussed in the September 2022 Board Meeting), has not yet taken place therefore further revisions may be proposed. Similarly, the Task Force has not proposed revisions to Part 6.8, *Specific Documentation Requirements* as the approach to documentation will be addressed in the March 2023 Board meeting.
51. The Task Force is of the view that Part 6, after the proposed revisions, still supports the auditor to obtain reasonable assurance.

⁸ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Matters for Board Consideration

6. The Board is asked for their views on proposed Part 6 as presented in **Agenda item 3-F. Appendix 3** to this agenda item sets out the planned approach for the discussion and obtaining views from the Board.

III. Other Matters**Quantitative Thresholds***Background*

52. As described in the [June Issues Paper](#), the Task Force considered respondents' suggestions to include quantitative thresholds in the Authority of the proposed ISA for LCE. While the Task Force noted complexity is not directly linked to size, it was acknowledged that the use of quantitative thresholds may serve as an additional 'safeguard' to limit the range of entities perceived to be within the scope of the proposed standard (not already have been scoped out through qualitative characteristics).
53. In September 2022, the Board discussed the expectation for legislative or regulatory authorities or relevant local bodies with standard-setting authority to determine quantitative thresholds for their jurisdiction and directed the Task Force to explore the addition of EEM or supplemental guidance to explain how quantitative measures were considered during the development of the proposed ISA for LCE and how existing thresholds such as those used in the European Commission's definition of a "small" enterprise⁹ may be used as a point of reference.

Changes to Authority

54. The Task Force considered the views provided by the Board and proposes further revisions to the Authority:
- (a) "Stronger" wording to reflect the expectation of legislative or regulatory authorities or relevant local bodies with standard-setting authority to determine quantitative thresholds (i.e., new introductory sentence explaining the purpose and a change from "provides for" to "anticipates" in paragraph A.4.).
 - (b) Additional EEM under paragraph A.4. to describe how quantitative measures are relevant to the use of the proposed standard and how existing thresholds may be used as a point of reference. The EEM refers to the European Commission definitions as an example of benchmarks that may be appropriate and indicates that it may be adjusted as appropriate for the circumstances of the individual jurisdiction.
55. As described in the [September 2022 Issues Paper](#), it is the intent of the Task Force to provide more non-authoritative supplemental guidance to assist with determining thresholds, including illustrative examples of how legislative or regulatory authorities or relevant local bodies with standard setting authority may determine thresholds for their jurisdiction. This would include how they may adjust an existing threshold to meet the needs of the jurisdiction.

⁹ Source: https://single-market-economy.ec.europa.eu/smes/sme-definition_en

56. Please see below the proposed changes to the Authority.

Quantitative Thresholds

- A.4. Determining quantitative thresholds assists in the consistent and appropriate use of the ISA for LCE in a jurisdiction. This section anticipates that Part provides for legislative or regulatory authorities or relevant local bodies with standard setting authority will to determine quantitative threshold(s) for use of the ISA for LCE in their respective jurisdictions.

~~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 applicable entities within the jurisdiction in general, or different thresholds may be set for entities within a specific or certain industry(ies) or for certain classes of entities. In doing so, consideration is to be given to the specific prohibitions for use of the ISA for LCE and the qualitative characteristics of a typical LCE, as set out in this Part, as well as other specific circumstances or needs that may be relevant in the jurisdiction. While complexity is not always directly relative to the size of an entity or its activities, complexity often increases when key quantitative measures (e.g., revenue, total assets, employee numbers etc.,) increase.~~

~~When determining thresholds for the use of the ISA for LCE, existing definitions or thresholds in a jurisdiction may be considered. The IAASB discussed thresholds established in various jurisdictions in determining the characteristics of a typical LCE. Such thresholds may be useful as a reference point for jurisdictions in setting thresholds. For example, the quantitative indicators described in the European Commission definition of a “small” enterprise¹⁰ may be used by jurisdictions as a base to be adjusted for the circumstances of the jurisdiction.~~

~~When the auditor is 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.~~

Matters for Board Consideration

7. The Board is asked for its views on the proposed revisions to the Authority relating to quantitative thresholds.

Questions 7(b) and 7(d): Approach to Objectives and EEM

57. The Task Force decided to present the analysis of the responses to questions 7(b) and 7(d) at this time, as these questions address topics that are pervasive to all Parts. These questions asked for

¹⁰ The European Commission defines a small enterprise as an enterprise which employs fewer than 50 persons and whose annual turnover or annual balance sheet total does not exceed EUR 10 million. Source https://single-market-economy.ec.europa.eu/smes/sme-definition_en.

respondents' views on the proposed approach to the use of objectives in the proposed standard, as well as the proposed approach to EEM (including its content, sufficiency and presentation).

What We Heard – Respondents Comments

Question 7(b) – Approach to Objectives

58. As described in paragraphs 78 to 80 of the EM, each Part of the ED-ISA for LCE contains objective(s) to be achieved by performing procedures to comply with the requirements within that Part. The objectives focus the auditor on:
- (a) Understanding what needs to be accomplished; and
 - (b) Deciding whether more needs to be done in the particular circumstances of the audit.
59. Respondents across a range of jurisdictions and stakeholder groups supported the approach to the objectives in each Part of the ED-ISA for LCE, with comments noting the approach was appropriate and clear. Respondents noted that more practical examples and guidance to support the application of objectives would be useful.

Question 7(d) – Approach to EEM

60. As described in paragraphs 85 to 91 of the EM, ED-ISA for LCE includes EEM where it has been considered that explanatory material is crucial to support the requirements or concepts used. The EEM serves a similar purpose to application and other explanatory material in the ISAs, but is much more limited and is targeted at a higher level (i.e., a conceptual and contextual level), taking into account the typical nature and circumstances of audits for which the proposed standard has been designed. EEM does not in itself impose a requirement or expand any requirement. Rather it is used when the explanation or guidance it provides is considered to be so important that including it in the proposed standard and positioning it alongside the requirement(s) is deemed necessary and informative for a proper understanding of the requirement(s). EEM also includes specific considerations for public sector entities and when using automated tools and techniques.
61. Question 7(d) of the EM asked for feedback specifically on the content, sufficiency and presentation of the EEM and has been considered with the more general feedback already discussed in June 2022.¹¹
62. Regarding the content of the EEM included in the ED-ISA for LCE, there was, on balance, support for the approach but respondents noted that content could be more proportionate or specific to an LCE or further simplified. It was noted that the level of detail in the EEM was not always consistent between different topics and parts. While some respondents called for further EEM on scalability, others noted that scalability should be addressed through changes in the requirements.
63. There were mixed views regarding the sufficiency of the EEM. On one hand, respondents noted that although the requirements in the ISAs were included almost in their entirety in ED-ISA for LCE, there was very little application material from the ISAs included which may lead to inconsistent use of

¹¹ For completeness, comments specific to the overall content, sufficiency and presentation of EEM from other questions discussed in June 2022 have been mapped to 7(d) (as reflected in Supplement 2-03) so all relevant themes can be analyzed together. Detailed comments on individual paragraphs of EEM (i.e., rather than overall approach) are mapped to Q9, to be considered when revising the content of the specific Part.

requirements (which may worsen as practitioners' knowledge of the ISAs may fade over time). These respondents were concerned that there was not enough guidance to support the consistent understanding, interpretation and application of the requirements without a working knowledge of the ISAs or auditing more generally. Respondents provided examples of specific areas where more EEM was appropriate.

64. On the other hand, other respondents supported the overall sufficiency of guidance that was included in the body of the draft standard, noting additional guidance may also be provided outside of the proposed standard, for instance through implementation or non-authoritative guidance. Respondents also highlighted the importance of timeliness of such materials.
65. Respondents generally supported the presentation of EEM. Respondents had suggestions to make the EEM more user friendly, including adding headings, numbering and reviewing its location within the requirement paragraphs. Respondents did raise concern regarding the intent and perceived status or authority of the EEM (particularly as it is described as “essential”) and how that might compare with guidance in a supplemental guide (non-authoritative).

The Task Force Views and Recommendations

66. Based on respondent feedback, the Task Force does not propose to change the approach to objectives in the proposed ISA for LCE.
67. With respect to the EEM, considering that the proposed standard is designed to be proportionate to the typical nature and circumstances of an audit of an LCE and that the standard will be accompanied by implementation and supplemental guidance, the Task Force is of the view that the overall approach to EEM within the draft standard does not need to change. The Task Force does acknowledge that there are areas where further EEM (or revisions to existing EEM) may be appropriate to enhance the application of a requirement.
68. The Task Force intends to address those identified areas requiring additional EEM (or changes to existing EEM) when revising each of the remaining parts. For Part 6, the Task Forces' proposed revisions have taken into account respondents' comments with respect to the EEM (as presented in **Agenda Item 3-A and 3-F**).

Matters for Board Consideration

8. The Board is asked for its views on the proposed way forward by the Task Force as set out in paragraph 66–68.

IV. Next Steps

69. The Task Force will continue to analyze, and present to the Board for discussion, the responses to questions included in the EM as set out in **Appendix 2**. This includes considering the appropriate time to do so based on the significance of the feedback and the timing of related drafting for individual Parts of the proposed standard.
70. The Task Force will continue the drafting of updates in further areas identified as in need of more significant revisions (e.g., engagement and firm level quality management, accounting estimates, documentation, planning activities) with the plan to discuss proposed revisions with the Board in

March 2023. The Task Force intend to bring a revised draft of the full proposed standard (excluding Part 10, *Group Audits*) to the Board in June 2023.

Task Force Members and Activities

Task Force Members

1. The Task Force consists of the following members:
 - Kai Morten Hagen, IAASB Member, Task Force Chair and IFAC Small and Medium Practitioners (SMP) Advisory Group Liaison
 - Julie Corden, IAASB Member
 - Chun Wee Chiew, IAASB Member
 - Sachiko Kai, IAASB Member
 - Vivienne Bauer, IAASB Technical Advisor
2. Further information and all posted documents relating to this project can be found [here](#).

Task Force Activities Since the September 2022 IAASB Meeting

3. The Task Force held one in-person meeting and two virtual meetings.

Outreach Since the September 2022 IAASB Meeting

4. The Task Force Chair attended the following outreach events or meetings in which the proposed ISA for LCE was discussed:
 - LCE Reference Group Meeting – a verbal debrief of the discussion will be provided during the December meeting.
 - IFAC SMP Advisory Group – a verbal debrief of the discussion will be provided during the December meeting.
5. The proposed ISA for LCE was addressed in meetings with the following stakeholders during the as part of the general outreach program:
 - International Organization of Supreme Audit Institutions.
 - Forum of Firms.
 - Public Interest Oversight Board.

Appendix 2

Reconciliation of ED-ISA for LCE Question Analysis

The below table presents a reconciliation of the questions provided to respondents of ED-ISA for LCE, along with the date of when a detailed analysis of comments was presented to the Board for discussion.

Q#	Text of Question per Explanatory Memorandum (ED-ISA for LCE)	Detailed Analysis to Board
1	Views are sought on:	
1(a)	The standalone nature of the proposed standard, including detailing any areas of concern in applying the proposed standard, or possible obstacles that may impair this approach?	June 2022
1(b)	The title of the proposed standard.	June 2022
1(c)	Any other matters related to ED-ISA for LCE as discussed in this section (Section 4A).	June 2022
2	Do you agree with the proposed conforming amendments to the IAASB Preface? If not, why not, and what further changes may be needed?	To Follow
3	Views are sought on the Authority (or scope) of ED-ISA for LCE (Part A of the proposed standard). In particular:	
3(a)	Is the Authority as presented implementable? If not, why not?	June 2022
3(b)	Are there unintended consequences that could arise that the IAASB has not yet considered?	June 2022
3(c)	Are there specific areas within the Authority that are not clear?	June 2022
3(d)	Will the Authority, as set out, achieve the intended objective of appropriately informing stakeholders about the scoping of the proposed standard?	June 2022
3(e)	Is the proposed role of legislative or regulatory authorities or relevant local bodies with standard setting authority in individual jurisdictions clear and appropriate?	June 2022
4	Do you agree with the proposed limitations relating to the use of ED-ISA for LCE? If not, why and what changes (clarifications, additions or other amendments) need to be made? Please distinguish your response between the:	
4(a)	Specific prohibitions	June 2022

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Q#	Text of Question per Explanatory Memorandum (ED-ISA for LCE)	Detailed Analysis to Board
4(b)	Qualitative characteristics.	June 2022
5	Regarding the Authority Supplemental Guide:	
5(a)	Is the guide helpful in understanding the Authority? If not, why not?	June 2022
5(b)	Are there other matters that should be included in the guide?	June 2022
6	Are there any other matters related to the Authority that the IAASB should consider as it progresses ED-ISA for LCE to finalization?	June 2022
7	Views are sought on the key principles used in developing ED-ISA for LCE as set in this Section 4C. Please structure your response as follows:	
7(a)	The approach to how the ISA requirements have been incorporated in the proposed standard.	June 2022
7(b)	The approach to the objectives of each Part of the proposed standard.	December 2022
7(c)	The principles in relation to professional skepticism and professional judgement, relevant ethical requirements and quality management.	To Follow
7(d)	The approach to EEM including: (i) The content of the EEM, including whether it serves the purpose for which it is intended. (ii) The sufficiency of EEM. (iii) The way the EEM has been presented within the proposed standard.	December 2022
8	Please provide your views on the overall design and structure of ED-ISA for LCE., including where relevant, on the application of the drafting principles	June 2022
9	Please provide your views on the content of each of Parts 1 through 8 of ED-ISA for LCE, including the completeness of each part. In responding to this question, please distinguish your comments by using a subheading for each of the Parts of the proposed standard.	Part 6 Dec 2022 – Other Parts to Follow
10	For Part 9, do you agree with the approach taken in ED-ISA for LCE with regard to auditor reporting requirements, including:	

Q#	Text of Question per Explanatory Memorandum (ED-ISA for LCE)	Detailed Analysis to Board
10(a)	The presentation, content and completeness of Part 9.	To Follow
10(b)	The approach to include a specified format and content of an unmodified auditor's report as a requirement?	To Follow
10(c)	The approach to providing example auditor's reports in the Reporting Supplemental Guide.	To Follow
11	With regard to the Reporting Supplemental Guide:	
11(a)	Is the support material helpful, and if not, why not?	To Follow
11(b)	Are there any other matters that should be included in relation to reporting?	To Follow
12	Are there any areas within Parts 1–9 of the proposed standard where, in your view, the standard can be improved? If so, provide your reasons and describe any such improvements. It will be helpful if you clearly indicate the specific Part(s) which your comments relate to.	Part 6 Dec 2022 – Other Parts to Follow
13	Please provide your views on transitioning:	
13(a)	Are there any aspects of the proposed standard, further to what has been described above, that may create challenges for transitioning to the ISAs?	To Follow
13(b)	What support materials would assist in addressing these challenges?	To Follow
14	Do you agree with the proposed approach to the future updates and maintenance of the Standard and related supplemental guidance?	To Follow
15	For any subsequent revisions to the standard once effective, should early adoption be allowed? If not, why not?	To Follow
16	Should a separate Part on the ISA-800 series be included within ED-ISA for LCE? Please provide reasons for your response.	To Follow
17	In your view, would ED-ISA for LCE meet the needs of users and other stakeholders for an engagement that enables the auditor to obtain reasonable assurance to express an audit opinion and for which the proposed standard has been developed? If not, why not. Please structure your comments to this question as follows:	
17(a)	Whether the proposed standard can, and will, be used in your jurisdiction.	June 2022

Q#	Text of Question per Explanatory Memorandum (ED-ISA for LCE)	Detailed Analysis to Board
17(b)	Whether the proposed standard meets the needs of auditors, audited entities, users of audited financial statements and other stakeholders.	June 2022
17(c)	Whether there are aspects of the proposed standard that may create challenges for implementation (if so, how such challenges may be addressed).	To Follow
18	Are there any other matters related to ED-ISA for LCE that the IAASB should consider as it progresses the proposed standard to finalization?	To Follow
19	What support and guidance would be useful when implementing the proposed standard?	To Follow
20	Translations—recognizing that many respondents may intend to translate the final ISA for LCE in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing ED-ISA for LCE.	To Follow
21	Effective Date—Recognizing ISA for LCE is a new standard, and given the need for national due process and translation, as applicable, the IAASB believes that an appropriate effective date for the standard would be for financial reporting periods beginning at least 18 months after the approval of a final standard. Earlier application would be permitted and encouraged. The IAASB welcomes comments on whether this would provide a sufficient period to support effective implementation of the ISA for LCE.	To Follow
22	The IAASB is looking for views on whether group audits should be excluded from (or included in) the scope of ED-ISA for LCE. Please provide reasons for your answer.	June 2022
23	Respondents in public practice are asked to share information about the impact of excluding group audits from the scope of ED-ISA for LCE on the use of the proposed standard. In particular:	
23(a)	Would you use the standard if group audits are excluded? If not, why not?	June 2022
23(b)	Approximately what % of the audits within your firm or practice would be group audits that would likely be able to use ED-ISA for LCE (i.e., because it is likely that such group audits could be considered less complex entities for the purpose of the proposed standard) except for the specific exclusion?	June 2022
23(c)	What common examples of group structures and circumstances within your practice would be considered a less complex group.	June 2022

Q#	Text of Question per Explanatory Memorandum (ED-ISA for LCE)	Detailed Analysis to Board
24	<p>If group audits are to be included in the scope of ED-ISA for LCE, the IAASB is looking for views about how should be done (please provide reasons for your preferred option):</p> <p>(a) The IAASB establishes a proxy(ies) for complexity for when the proposed standard may be used (“Option 1 - see paragraph 169); or</p> <p>(b) ED-ISA for LCE sets out qualitative characteristics for complexity specific to groups (Option 2 - see paragraph 176), to help users of the proposed standard to determine themselves whether a group would meet the complexity threshold.</p>	June 2022
25	<p>Are there other ways that group audits could be incorporated into the scope of the proposed standard that is not reflected in the alternatives described above? For example, are there proxies for complexity other than what is presented in paragraph 169 that the IAASB should consider?</p>	June 2022
26	<p>If group audits are included in ED-ISA for LCE, how should the relevant requirements be presented within the proposed standard (please provide reasons for your preferred option):</p> <p>(a) Presenting all requirements pertaining to group audits in a separate Part; or</p> <p>(b) Presenting the requirements pertaining to group audits within each relevant Part.</p>	June 2022

Appendix 3

Approach for the Discussion of Part 6, *Risk Identification and Assessment*

Section in Agenda Item 3–E and 3–F	Paragraphs (including the related EEMs) in Agenda Item 3–E and 3–F
Content of this Part Scope of this Part 6.1. Objectives 6.2. Procedures for Identifying and Assessing Risks and Related Activities	Introductory Box 6.1.1.–6.2.6.
6.3. Understanding Relevant Aspects of the Entity <i>Inquiries of Management and Others within the Entity</i> <i>Understanding the Entity and Its Environment</i> <i>Understanding the Applicable Financial Reporting Framework</i>	6.3.A.–6.3.5.
6.3. Understanding Relevant Aspects of the Entity <i>Understanding the Entity’s System of Internal Control</i> <i>Deficiencies in the Entity’s System of Internal Control</i>	6.3.6.–6.3.18.
6.4. Identifying and Assessing Risks of Material Misstatement <i>Significant Risks</i> <i>Assessing Control Risk</i> <i>Evaluation of the Procedures to Identify and Assess Risks of Material Misstatement and Revision of Risk Assessment</i>	6.4.1.–6.4.3G.
6.5. Evaluation of the Appropriateness of Using the ISA for LCE 6.7. Specific Communication Requirements	6.5.A.–6.7.1.