

Audits of Less Complex Entities – Explanation of Significant Changes to Proposed ISA for LCE

This paper explains the significant changes and the rationale for the changes that have been made to targeted areas of the proposed International Standard on Auditing for Audits of Financial Statements of Less Complex Entities (ISA for LCE). The changes are explained from the Exposure Draft of the ISA for LCE (ED-ISA for LCE) except for Part 6. For Part 6, changes are explained from the draft presented to the Board in the December 2022 meeting.

The changes are reflected in the marked draft in **Agenda Item 6-B**.

Part 1, *Fundamental Concepts, General Principles and Overarching Requirements*

Paragraph	Significant Changes and the Rationale for Those Changes
1.9.1.	The LCE Task Force (the Task Force) moved the documentation requirement to 1.9.1 from paragraph 2.5.5. to match where the specific requirements in relation to communications on fraud are located. The Task Force intend to review this location further when considering possible revisions based on analysis of respondents to ED-ISA for LCE (respondents) comments to Part 1.

Part 2, *Audit Evidence and Documentation*

Paragraph	Significant Changes and the Rationale for Those Changes
2.2. Sufficient Appropriate Audit Evidence	
EEM under 2.2.2.	<ul style="list-style-type: none"> The Task Force deleted Essential Explanatory Material (EEM) that was deemed duplicative to EEM under paragraph 2.3.1 based on respondent's comments.
2.3. Information to be Used as Audit Evidence	
EEM under 2.3	<ul style="list-style-type: none"> The Task Force moved EEM that was previous placed under paragraph 2.4 in ED-ISA for LCE as respondents noted that it was confusing to include EEM in a separate section that did not contain any requirements.

Paragraph	Significant Changes and the Rationale for Those Changes
2.5. General Documentation Requirements	
EEM under 2.5	<ul style="list-style-type: none"> • Second paragraph. Based on respondents' comments, the Task Force added additional EEM from paragraph A5 of ISA 230,¹ relating to oral explanations, in order to provide more context (only half of the relevant sentence from ISA 230 had been included in ED-ISA for LCE). • Third paragraph. Based on respondents' comments, the Task Force added EEM based on paragraph A7 of ISA 230, to clarify that an auditor is not required to document every matter considered, or professional judgment made in an audit, based on suggestions from respondents. • Fourth paragraph. The Task Force added EEM to explain that in addition to the general documentation requirements set out in this Part, specific matters to be documented are set out throughout the standard (previously included in paragraph 2.5.1.)
2.5.1.	<ul style="list-style-type: none"> • The Task Force deleted the first sentence and instead included it as EEM under paragraph 2.5, as it did not contain a requirement and did not relate to the rest of paragraph 2.5.1. • The Task Force revised the wording in paragraph 2.5.1.(a)(iii) to be consistent with the relevant requirement in ISA 230 (paragraph 9 (c)) based on respondents' comments that it was unclear.
EEM under 2.5.1.	<ul style="list-style-type: none"> • The Task Force moved the EEM that was under paragraph 2.5.1. (a) to under 2.5.1 to increase readability of the requirement.
2.5.2.	<ul style="list-style-type: none"> • The Task Force moved paragraph 2.5.2 to paragraph 7.7.3 to match where the corresponding performance requirement is included.
2.5.5. (a)	<ul style="list-style-type: none"> • The Task Force moved this requirement to paragraph 1.9.1. to match where the corresponding performance requirement is included.

¹ International Standard on Auditing (ISA) 230, *Audit Documentation*

Paragraph	Significant Changes and the Rationale for Those Changes
2.5.5. (b)	<ul style="list-style-type: none"> The Task Force moved this requirement to paragraph 7.7.3 to match where the corresponding performance requirement is included.

Part 3, Engagement Quality Management

Paragraph	Significant Changes and the Rationale for Those Changes
3.2. The Engagement Partner's Responsibilities	
EEM under 3.2.	<ul style="list-style-type: none"> The Task Force added EEM to signal that the text in the boxes is only applicable when there are engagement team members other than the engagement partner. Also see Agenda Item 6, paragraph 34(a).
3.2.1–3.2.4.	<ul style="list-style-type: none"> Based on respondents' comments the Task Force restructured paragraphs 3.2.1–3.2.4. See Agenda Item 6, paragraph 34(b). Changes are made as a result of this restructuring.
3.2.1.	<ul style="list-style-type: none"> Paragraph 3.2.1(b) was previously included in the lead-in of paragraph 3.2.2 and was moved because of the restructuring of paragraphs 3.2.1–3.2.4. Similarly, the EEM that relates to the engagement partner's responsibility for managing and achieving quality was moved from under paragraph 3.2.2. to under paragraph 3.2.1(b)
EEM under 3.2.2.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 34(b)(ii).
EEM under 3.2.6.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 35(c).
3.2.9.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 34(b)(ii).
3.2.10.	<ul style="list-style-type: none"> The Task Force made several changes to improve the understandability of the requirement and make more direct and appropriate for an audit of an LCE.
EEM under 3.2.13A.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 34(b)(ii).

Part 4, Acceptance or Continuance of an Audit Engagement and Initial Audit Engagements

Paragraph	Significant Changes and the Rationale for Those Changes
4.4. Additional Considerations in Engagement Acceptance	
4.4.1.	<ul style="list-style-type: none"> The Task Force removed “including the appropriate use of the [draft] ISA for LCE” since it is duplicative of what is required by paragraph 4.2.1.
4.5. Terms of the Audit Engagement	
EEM above 4.5.1.	<ul style="list-style-type: none"> The Task Force removed the second paragraph since it is duplicative of paragraph 4.5.1.
EEM under 4.5.4.	<ul style="list-style-type: none"> The Task Force added EEM to explain that the auditor may need to assess any legal or contractual implications of the change from an audit engagement to an engagement that conveys a lower level of assurance. This guidance was deemed necessary by the respondents.
4.6. Initial Audit Engagements	
EEM under 4.6.4.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 45.
4.8. Specific Documentation Requirements	
4.8.4.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 42.

Part 5, Planning

Paragraph	Significant Changes and the Rationale for Those Changes
5.2. Planning Activities	
EEM under 5.2.2.	<ul style="list-style-type: none"> The Task Force aligned the wording closer to ISA 300² paragraph A11. Also, based on respondents' comments, the Task Force clarified that the memorandum does not need to be completed during the previous year's audit.
<i>Using the Work of Management's Expert</i>	
EEM under 5.2.8.	<ul style="list-style-type: none"> Based on respondents' comments, the Task Force added EEM based on ISA 500³ paragraphs A48, A50, A57 and A59. Respondents noted that guidance would be useful to apply requirements in relation to using the work of a management's expert.
Going Concern	
EEM above 5.2.12.	<ul style="list-style-type: none"> Given the movement of paragraph 5.2.12, the Task Force also moved the EEM to paragraph 6.3.A. Also, see Agenda Item 6, paragraphs 53–54.
5.2.12.	<ul style="list-style-type: none"> Now reflected at paragraph 6.3.A - see Agenda Item 6, paragraphs 53–54.
EEM under 5.2.12.	<ul style="list-style-type: none"> Given the movement of paragraph 5.2.12, the Task Force proposes to move the EEM to Part 7 as it relates to obtaining sufficient appropriate audit evidence and concluding on going concern thus deemed to be more appropriately placed in Part 7. The location in Part 7 will be determined when revisions to the remaining requirements in Part 7 are discussed.
5.2.13.	<ul style="list-style-type: none"> The Task Force moved the requirement to paragraph 6.4.3H. As it relates to remaining alert to events or conditions throughout the audit, the Task Force is of the view that the requirement is best placed after the risk assessment in Part 6.

² ISA 300, *Planning an Audit of Financial Statements*

³ ISA 500, *Audit Evidence*

Paragraph	Significant Changes and the Rationale for Those Changes
5.3. Materiality	
EEM under 5.3.1.	<ul style="list-style-type: none"> • Second paragraph. The Task Force removed the bullets to streamline the EEM. The Task Force is of the view that the deleted content is covered by the first paragraph of the EEM under 5.3.1. • Third paragraph. Based on respondents' comments (also see Agenda Item 6, paragraph 48(c)), the Task Force added EEM to provide guidance related to identifying an appropriate benchmark. This guidance is based on ISA 320⁴ paragraph A4. • Fourth paragraph. Based on respondents' comments, the Task Force removed the last sentence. Respondents noted that the EEM should not give the impression that profit before tax is the preferred basis for determining materiality since it may not always be an appropriate benchmark. • Fifth paragraph. Based on respondents' comments, the Task Force added guidance based on ISA 320 paragraph A8. Also see Agenda Item 6, paragraph 48(c). • Seventh paragraph, based on respondents' comments, the Task Force added EEM based on ISA 320 paragraph A10 to provide guidance related to identifying an appropriate benchmark for a public sector entity.
EEM under 5.3.3.	<ul style="list-style-type: none"> • Second paragraph. Based on respondents' comments, the Task Force added EEM based on ISA 320 paragraph A13. Respondents noted more guidance is needed on determining performance materiality. The Task Force noted that a part of ISA 320 paragraph A13 was already included in the EEM for ED-ISA for LCE and was of the view that the remainder of the guidance was useful. • Third paragraph. Based on respondents' comments, the Task Force added EEM based on paragraph A3 of ISA 450⁵ which explains that auditors may designate an amount below which misstatements of amounts in the individual statements would be clearly trivial misstatements to address respondents' suggestion that such a calculation would normally be performed at an earlier stage of the audit.

⁴ ISA 320, *Materiality in Planning and Performing an Audit*

⁵ ISA 450, *Evaluation of Misstatements Identified During the Audit*

Paragraph	Significant Changes and the Rationale for Those Changes
5.5. Specific Documentation Requirements	
5.5.2.	<ul style="list-style-type: none"> The Task Force removed this requirement as it already addressed through requirements in the other Parts and does not relate to a specific requirement in Part 5.
5.5.4.(d).	<ul style="list-style-type: none"> The Task Force moved requirements previously duplicated in paragraphs 7.7.1.(e) and 8.9.1.(a) to Part 5 to reflect the addition of EEM under paragraph 5.3.3. The Task Force included “if calculated” so it was clear the documentation requirement is applicable only when an amount below which misstatements would be clearly trivial is calculated. The Task Force had the view it may not always be necessary to calculate a clearly trivial “threshold” given the less complex nature and volume of transactions in an LCE and thus potentially lower volume and complexity of misstatements. In an LCE an auditor may accumulate all the misstatements, particularly given an auditor is required to consider the nature of the misstatements not just the value when considering if they are clearly trivial in accordance with paragraph 7.5.1.

Part 6, Risk Identification and Assessment

Paragraph	Significant Changes and the Rationale for Those Changes
6.2. Procedures for Identifying and Assessing Risks and Related Activities	
6.2.1A.	<ul style="list-style-type: none"> Based on Board comments, the Task Force moved this paragraph up from its previous location as paragraph 6.2.4 to provide a more logical flow as the requirement relates to what should be performed when obtaining evidence to address paragraph 6.2.1. Updated to “<i>when obtaining</i>” to make it clearer that these are not the only areas considered or procedures performed when addressing paragraph 6.2.1.
EEM under 6.2.3.	<ul style="list-style-type: none"> The Task Force made various clarifying edits relating to circumstances specifically relevant to LCEs based on suggestions from the Board.

Paragraph	Significant Changes and the Rationale for Those Changes
6.3. Understanding Relevant Aspects of the Entity	
EEM under 6.3.	<ul style="list-style-type: none"> The Task Force revised for better clarification of what is included in the auditors understanding of relevant aspects of the entity (consistent with sub-headers in section 6.3 that follows) based on Board comments.
6.3.A.	<ul style="list-style-type: none"> Paragraph 6.3.A(a): The Task Force added “business” before “risks” to be consistent with ISA 315 (Revised 2019)⁶ paragraph 22, based on Board comments. Paragraph 6.3.A.(e): Based on Board comments, the Task Force revised the inquiry to cover if the entity is in compliance with laws or regulations that may have an effect on the financial statements rather than those that may have a <i>material</i> effect which is consistent with the requirement in paragraph 15 of ISA 250 (Revised).⁷ This was deemed appropriate for an audit of an LCE as it is an inquiry to management used as a risk identification and assessment procedure and so by being less specific would prevent management not disclosing potentially relevant matters they believed not to be material. The Task Force noted that the further audit procedures relating to compliance with laws and regulations are included in paragraph 7.2.4. The Task Force also added an inquiry regarding if there was any correspondence with relevant licensing or regulatory authorities that may be relevant to the financial statements. This inquiry would assist the auditor in identifying matters that might be relevant for risk identification and assessment. This addition is based on paragraph 15 of ISA 250 (Revised). Paragraph 6.3.A.(f): The Task Force added an inquiry relating to Going Concern which had previously been addressed in Part 5 (paragraph 5.2.12), and reworded the requirement to be more direct and appropriate for an LCE as the Task Force noted it would be unlikely for the management to perform a preliminary assessment, or if they did it would be likely to be informal. The Task Force have the view that the outcome of the requirement remains similar to previous requirement (i.e., to understand the basis for the intended use of going concern basis of accounting, whether events or conditions exist that may cast significant doubt, and if so, managements plans to address them).
EEM under 6.3.A.	<ul style="list-style-type: none"> The Task Force proposed revisions to EEM to reflect the changes in the corresponding requirements (as described above).

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

⁷ ISA 250 (Revised), *Consideration of Laws and Regulations in an Audit of Financial Statements*

Paragraph	Significant Changes and the Rationale for Those Changes
6.3.B.	<ul style="list-style-type: none"> The Task Force reversed a change previously proposed in December 2022. The way it is described is now consistent with how described in other areas of the proposed ISA for LCE.
6.3.9.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(b).
6.3.12A.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(c).
6.3.12B. and related EEM	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(d). The Task Force proposed additional wording to clarify that requirement is only relevant when the services provided by a service organization are relevant to the process to prepare its financial statements consistent with paragraph 3 of ISA 402⁸ (adapted for the terminology at paragraph 6.3.9). This is to address respondents' comments that the scope of what services need to be addressed by this requirement was unclear. The Task Force also added EEM based on paragraph 3 of ISA 402 to further explain what is meant by 'relevant to the entity's process to prepare its financial statements'. The Task Force removed 6.3.12B (d) and (e) as the understanding of controls relevant to the entity's process to prepare its financial statements is already addressed in paragraph 6.3.9. This is consistent with the approach taken in ISA 315 (Revised 2019) and ISA 402. The Task Force added EEM to explain that the understanding is in addition to that required in paragraph 6.3.9. The Task Force is of the view this will assist in making clearer the scope of work to be performed.
6.3.14. and related EEM	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(d). The Task Force removed paragraph 6.3.14.(d). This is consistent with paragraph 10 of ISA 402 where the user auditor is required to evaluate the design and implementation of identified controls in accordance with ISA 315 (Revised 2019). The Task Force is of the view that the understanding of the entity's process to prepare its financial statements (paragraph 6.3.9.) would assist the auditor identify those controls and so it is not necessary (and may be confusing) to include a separate requirement in paragraph 6.3.14. specifically for identified controls relating to service organizations. To address respondents' comments that the applicability of requirements relating to service organizations was not clear, the Task Force added EEM to remind auditors that the identified controls described in the requirement may include those at the user entity related to a service organization.

⁸ ISA 402, *Audit Considerations Relating to an Entity Using a Service Organization*

Paragraph	Significant Changes and the Rationale for Those Changes
6.4 Identifying and Assessing the Risks of Material Misstatement	
6.4.1.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(e).
EEM under 6.4.1.	<ul style="list-style-type: none"> The Task Force proposed additions and revisions to follow the order of the steps in paragraph 6.4.1 and provide further guidance to explain some of the key concepts (e.g., the difference between a financial statement level risk and an assertion level risk, and what a relevant assertion is). Although these concepts are defined in the glossary, the Task Force is of the view that including EEM would be helpful, particularly as respondents noted auditors may struggle with the technical concepts.
6.4.1A. and related EEM	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(e).
6.4.2.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 58(a).
6.4.3A.	<ul style="list-style-type: none"> The Task Force added additional factors (“change” and “management bias”) that may be relevant to identify and assess the risks of material misstatement relating to an accounting estimate. These are consistent with the factors that may be relevant when assessing inherent risk described in the EEM under paragraph 6.4.1.
6.4.3D.	<ul style="list-style-type: none"> The Task Force restructured this paragraph to better clarify which risks are significant risks. In addition, the Task Force moved a part of the requirement in 6.4.3D to EEM as it does not contain an additional requirement. This is consistent with the drafting conventions of the proposed ISA for LCE.
6.4.3H. and related EEM	<ul style="list-style-type: none"> The Task Force moved the requirement from paragraph 5.2.13. As it relates to remaining alert to events or conditions throughout the audit, the Task Force is of the view that the requirement is best placed after the risk assessment in Part 6. The Task Force also moved a part of EEM from EEM under paragraph 7.4.2. as it is relevant in explaining that risks of material misstatement may need to be revised if events or conditions are identified after the risk assessment, and so inclusion with the requirement at 6.4.3H was more appropriate.

Paragraph	Significant Changes and the Rationale for Those Changes
6.8. Specific Documentation Requirements	
EEM under 6.8.1.(c).	<ul style="list-style-type: none"> The Task Force removed EEM that was no longer relevant due to changes to the corresponding requirements.

Part 7, Responding to Assessed Risks of Material Misstatement – Requirements for Accounting Estimates Only

Paragraph	Significant Changes and the Rationale for Those Changes
7.4 Specific Focus Areas	
7.4.8.	<ul style="list-style-type: none"> Based on respondents’ comments, the Task Force enhanced paragraph 7.4.8.(b). Respondents noted that the requirement was missing a “shall”.
7.4.16.	<ul style="list-style-type: none"> The Task Force deleted this requirement as it was deemed duplicative. The Task Force is of the view that it is sufficiently covered by the general requirement to respond to the assessed risks of material misstatement as set out in paragraph 7.3.1. of the ED-ISA for LCE
7.4.17.	<ul style="list-style-type: none"> Given the introduction of sub-sections for each of the testing approaches, the Task Force moved this requirement to the section on how management made the accounting estimate. This is consistent with where this paragraph is placed in ISA 540 (Revised).⁹ Also see Agenda Item 6, paragraph 67(a).
7.4.18.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 67(a).
EEM under 7.4.18.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 67(d).
7.4.18A.	<ul style="list-style-type: none"> See Agenda Item 6, paragraph 67(c).

⁹ ISA 540 (Revised), *Auditing Accounting Estimates and Related Disclosures*

Paragraph	Significant Changes and the Rationale for Those Changes
7.4.18B.	<ul style="list-style-type: none"> • See Agenda Item 6, paragraph 67(a).
7.4.18C.	<ul style="list-style-type: none"> • See Agenda Item 6, paragraph 67(a).
EEM under 7.4.18C.	<ul style="list-style-type: none"> • See Agenda Item 6, paragraph 67(b)(i).
7.4.18D.	<ul style="list-style-type: none"> • See Agenda Item 6, paragraph 67(a).
EEM under 7.4.18D.	<ul style="list-style-type: none"> • See Agenda Item 6, paragraph 67(b).
7.4.18E.	<ul style="list-style-type: none"> • See Agenda Item 6, paragraph 67(a).
EEM under 7.4.18E.	<ul style="list-style-type: none"> • This EEM was added based on suggestions from respondents. The Task Force was of the view that it would be useful to explain that: <ul style="list-style-type: none"> ○ The auditor’s decision as to whether to develop a point estimate rather than a range may depend on the nature of the accounting estimate and the auditor’s judgment in the circumstances; and ○ When the auditor develops a point estimate or range, the auditor is not expected to obtain audit evidence to support each possible outcome in the range individually. • Also, see Agenda Item 6, paragraph 67(b)(ii).
7.6 Specific Communication Requirements	
7.6.3.	<ul style="list-style-type: none"> • The Task Force revised this requirement to be consistent with the changes in Part 6, including paragraph 6.4.3A.

Paragraph	Significant Changes and the Rationale for Those Changes
7.7. Specific Documentation Requirements	
7.7.3.	<ul style="list-style-type: none"> As described in paragraphs 2.5.2 and 2.5.5 (b) above, the Task Force has moved documentation requirements relating to identified or suspected non-compliance with laws and regulations in order to match where the requirements are included (i.e., Part 7) and to remove duplication between the two previous requirements.

Part 8, Concluding

Paragraph	Significant Changes and the Rationale for Those Changes
8.9.1.(a).	<ul style="list-style-type: none"> Documentation requirement relating to a clearly trivial threshold has been moved to Part 5 (see comment at 5.5.4 above).

Appendices

Paragraph	Significant Changes and the Rationale for Those Changes
Appendix 2	<ul style="list-style-type: none"> The Task Force removed the box relating to information from auditors' previous experience and previous audits as those requirements are addressed in Part 5, not Part 6. Based on the direction of the Board regarding proposed changes to Part 6.4, and other areas of Part 6 the Task Force will consider if further revisions are needed to align.