

Supplement 1-05 to Agenda Item 6

Audits of Less Complex Entities – ED-ISA for LCE – Q9 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. (This supplement contains responses related to accounting estimates)

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 6\f. Specific Drafting Comments\6.3 Understanding Relevant Aspects of the Entity\m. 6.3.12

5. Accounting Firms

Famme & Co. Professional Corporation

6.3.12 In practice, none of our LCEs have processes for accounting estimates. No formal models are used. Estimates are usually triggered by enquiries from us during the audit.

PriceWaterhouseCoopers

Appendix 3 - Detailed Comments
Draft Standard

The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

Paragraph 6.3.12(d) - We believe the nature of this paragraph is different from ISA 540.14, which requires the auditor to review the outcome of previous accounting estimates. While we acknowledge that the nature of accounting estimates that will fall within the scope of the standard should be simpler, it is also true that the likely less formal processes of management and lower materiality levels mean that the risk of material misstatement arising from such informal processes still exists. We recommend ISA 540.14 be retained. At a minimum, the final sentence of ISA 540.14 is important EEM.

7. Professional Accountancy and Other Professional Organizations

Institute of Chartered Accountants in England and Wales

6.3.12: properly belongs after 6.3.9. © is already dealt with under other requirements relating to control and (d) rarely happens. Both could be eliminated. (d) is in any case covered by the requirements relating to estimates.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 6\f. Specific Drafting Comments\6.5 Risk Assessment\c. 6.5.2

5. Accounting Firms

Price Bailey LLP

6.5.1 and 6.5.2 - Is mainly repetitive and covered elsewhere and can be simplified, no need for a0 or b) no need to refer to “other inherent risk factors”.

7. Professional Accountancy and Other Professional Organizations

Institute of Chartered Accountants in England and Wales

The specific points suggested below may add to the length of the standard but will eliminate redundancies in the performance of very simple audits and help create the all-important clear blue water between this standard and the detailed ISAs.

6.5.1 and 6.5.2: much of this is effectively covered by the previous paragraphs. Most of the points are covered elsewhere in this section. 6.5.1: unnecessarily complex for LCEs. Part (a) can be deleted, as can the reference to inherent risk factors in part (b). 6.5.2: the reference to ‘other’ inherent risk factors should be deleted and the reference should be the susceptibility of the estimate to fraud, error or bias, deleting (a) and (b).

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 6\6.5 Risk Assessment\g. 6.5.6

4. National Auditing Standard Setters

Austrian Chamber of Tax Advisors and Public Accountants (KSW)

Considerations relating to “management bias” are included in the documentation requirement in paragraph 6.8.1.(f) for the first time. We suggest including them already in the requirements relating to risk assessment (significant risks), such as e.g., in requirement 6.5.6 or any other appropriate requirement.

5. Accounting Firms

Grant Thornton International Limited

Part 6, Risk Identification and Assessment

Overall, we are of the view that this Part needs to be further tailored to the specific needs of an audit of the financial statements of a less complex entity. As currently drafted, there would appear to be insufficient modification of the requirements to reflect that less complex entities typically have less sophisticated IT environments and that audits of the financial statements of less complex entities are generally more substantive in nature, with significantly less emphasis being placed on controls that the entity may have put in place. For example:

Paragraph 6.5.6 requires the auditor to determine whether accounting estimates are significant risks. Accounting estimates have been identified as one of the factors that may prevent an audit being performed under ED-ISA for LCE. As such, if an accounting estimate is identified as a significant risk, we would recommend that EEM, or even a requirement, is included in the Proposed Standard that prompts the auditor to consider whether it is appropriate to continue to use ED-ISA for LCE.

7. Professional Accountancy and Other Professional Organizations

Institute of Chartered Accountants in England and Wales

The specific points suggested below may add to the length of the standard but will eliminate redundancies in the performance of very simple audits and help create the all-important clear blue water between this standard and the detailed ISAs.

6.5.5 and .6: Suggest merge.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 7\7.4 Specific Focus Areas\2 Management Override of Controls

5. Accounting Firms

Grant Thornton International Limited

Paragraph 7.4.8(b) requires the auditor to perform a retrospective review of management judgments and assumptions related to significant accounting estimates. We question whether, in an audit of an LCE, there should be any significant accounting estimates given this is one of the characteristics that would prevent the auditor from using ED-ISA for LCE.

Mazars

7.4.8: We suggest that item (b) (ii) could be moved to the risk assessment part since this could be performed in that phase of the audit.

PriceWaterhouseCoopers

Appendix 3 - Detailed Comments
Draft Standard

The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

Paragraph 7.4.7 - The requirement to identify and treat management override as a significant risk is already captured in paragraph 6.5.7. Paragraph 7.4.7 is not drafted as a requirement but presented as a statement, which is effectively equivalent to EEM. Due to the inclusion of paragraph 6.5.7 we suggest this statement can be deleted. If not deleted, it should be converted to EEM.

Paragraphs 7.4.8 - As acknowledged in paragraph 6.3.6(d), the risk of management override of controls is perhaps greater in a LCE due to the less formal control environment. It would be useful to acknowledge this in EEM and how the auditor's response may need to be tailored.

6. Public Sector Organizations

Auditor-General of New Zealand

Part 7 – Responding to Assessed Risks of Material Misstatement

Paragraph: 7.4.7

Observation: This contains no "shall" statement.

Possible Correction: Perhaps this is extended explanatory material?

Paragraph: 7.4.8(b) and 7.4.16 to 7.4.18

Observation: There is an element of duplication in these requirements.

Possible Correction: Remove the duplication and include all requirements on accounting estimates under one heading.

7. Professional Accountancy and Other Professional Organizations

Finnish Association of Authorised Public Accountants

We present below some detailed comments about the different Parts of the draft standard that could, in our opinion, be streamlined further without compromising reasonable assurance and quality audit. We suggest that the IAASB increases alternativeness and the use of professional judgement in deciding whether a requirement is relevant or efficient in the circumstances. One should always consider the value of the procedure/requirement to the ultimate goal of the audit – a reasonable assurance on that the financial statement does not include material misstatements – not to the audit process. Our comments are given mainly from the Finnish point of view (low audit thresholds, big number of SMEs, big number of audits conducted entirely at once, big number of remote audits etc.) and they aim to the appropriateness of the standard in regard to an SME audit.

Management Override of Controls

Paragraph 7.4.7 does not include requirements and could be an EEM instead.

The inquiry requirement in paragraph 7.4.8(i) could be optional in owner-managed entities where the financial reporting process consists of the owner-manager and an accountant.

Institute for the Accountancy Profession in Sweden (FAR)

7.4.8: We suggest that item (b) (ii) could be moved to the risk assessment part since this could be performed in that phase of the audit.

Nordic Federation of Public Accountants

We suggest that 7.4.8. (b) (ii) could be moved to the risk assessment in part 6 since this could be performed in that phase of the audit.

8. Academics

Hunter College Graduate Program

Section 7.4.8 (a) (ED Pg 121)

Test the appropriateness on **all types of journal entries by** of manual and automated journal entries recorded in the general ledger and other adjustments, made in the preparation of the financial statements, including:

- (i) Making inquiries **on the inappropriate and unusual activities;** of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- (ii) **Test the** Selecting journal entries and other adjustments made at the end of a reporting period; and
- (iii) **Use professional judgment to decide if other journal entries need to be tested.** Considering the need to test journal entries and other adjustments throughout the period."

Section 7.4.8 (b) (ED Pg 121)

(i) Evaluate whether the judgments and decisions made by management indicate a possible bias on the part of the entity's management, ~~even if they are~~ **both** individually reasonable **and reasonable in combination**, that may represent a risk of material misstatement due to fraud. If so, the auditor shall reevaluate the accounting estimates taken as a whole; and

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 7\ b. Specific Drafting Comments\7.4 Specific Focus Areas\4 Accounting Estimates

3. Regulators and Audit Oversight Authorities

Independent Regulatory Board for Auditors (IRBA)

Editorial changes to paragraph 7.4.18.(a)-(b):

Formatting: It appears as if paragraph spacing is different from the rest of the document and appears to be “aligned left” rather than “justified”. It is suggested that it be corrected.

4. National Auditing Standard Setters

American Institute of Certified Public Accountants

The following represents those ISA paragraphs and corresponding ISA for LCE paragraphs that we assigned a “B” rating – meaning that omission or revision of the ISA requirement might create an issue for auditors when any one item is aggregated with another or others. We are pleased to provide additional information if requested.

ISA 540, paragraph 30/ - (omitted from Exposure Draft)

Institut der Wirtschaftspruefer in Deutschland e.V. (IDW)

It seems to us that paragraph 7.4.16. is redundant, because it is covered by the general requirement to respond to assessed risks of material misstatement.

5. Accounting Firms

Ernst & Young Global Limited

Accounting Estimates 7.4.16 – 7.4.18 - Specific procedures in relation to complex accounting estimates are not covered by the ED-ISA for LCE, which potentially makes the ED-ISA for LCE not applicable to many LCE audits. We suggest that the IAASB revisit this decision to exclude specific procedures in relation to the use of ISA 540 and allow the auditor to exercise judgement to determine if an estimate is complex and not in the spirit of the ED-ISA for LCE. Refer to Q4 for more details.

MNP LLP

Accounting estimates

Paragraph A.9 includes the characteristic of “...accounting estimates [that] are subject to a higher degree of estimation uncertainty or the measurement basis requires complex methods...”. We believe there are many entities that should be considered less complex, however contain one or two accounting estimates with a higher degree of estimation uncertainty. For example, there may be entities in the agriculture industries that have simple, less-complex operations however they have livestock (e.g., cattle) or fruit orchards that are treated like a complex estimate in audit due to the data and computations used. As well, if any intangible rights or goodwill are determined to be complex estimates, this will exclude a significant number of entities that otherwise would have been deemed to be less complex.

We expect that this qualitative characteristic will come up for many LCEs that undergo business combinations given there are typically more complicated estimates involved. This results in one year where the entity is deemed complex followed by the entity being deemed less complex in subsequent years. This will have further impacts on the audit opinion and the users’ perception of the audit report when practitioners are required to report using the LCE standard and then having to change to the full suite of ISAs due to the business combination (i.e., audit report’s prepared in accordance with different auditing standards). We believe that a practitioner should be able to use the ISA for LCE standard, consistently year-to-year, in scenarios where there are a limited number of estimates.

PriceWaterhouseCoopers

Appendix 2 - Illustrative Requirements Concept

This appendix has been developed to seek to illustrate how further simplification can be incorporated into proposed requirements to better meet stakeholder expectations, based on an assumption of a narrower Authority, to: (i) better reflect the nature and circumstances of entities that would fall within the scope of the ISA for LCE and (ii) provide further distinction from ISA requirements where possible. This illustration addresses risk assessment, and response to risks of material misstatements related to accounting estimates. The principle of broader distinction and simplification could be adopted across other Parts of the standard. In addition, as described in our response to question 8, this appendix also includes suggested revisions to the documentation requirements designed to enhance understanding and clarity.

Accounting estimates (Part 7):

Illustrative revisions	Comments
7. Responding to Assessed Risks of Material Misstatement	
7.4. Specific Focus Areas <i>Accounting Estimates</i>	
7.4.16 The auditor shall design and perform further audit procedures related to accounting estimates to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement at the assertion level, including for disclosures.	No change
<u>Evidence available from events occurring up to the date of the auditor's report</u> <u>7.4.16A When the outcome of an accounting estimate for which risks of material misstatement have been identified is known after the date of the financial statements but before the date of the auditor's report, the auditor shall obtain sufficient appropriate audit evidence from events occurring up to the date of the auditor's report. In doing so, the auditor shall evaluate any changes in circumstances and other relevant conditions between the event and the measurement date that may affect the relevance of such evidence.</u>	Proposed new requirement
7.4.17. <u>For accounting estimates for which the outcome is not yet known from events occurring up to the date of the auditor's report,</u> Tthe auditor's further audit procedures shall address whether, in the context of the applicable financial reporting framework, management has taken appropriate steps to understand estimation uncertainty and address that uncertainty by selecting appropriate point estimates. If management has not undertaken such steps, the auditor shall request management to perform additional procedures to address estimation uncertainty by reconsidering the selection of point estimates or providing additional disclosures related to the estimation uncertainty.	Added language to lead-in to make conditional on 7.4.16A.
7.4.18. <u>For accounting estimates for which the outcome is not yet known from events occurring up to the date of the auditor's report,</u> Tthe auditor's further audit procedures to respond to assessed risks of material misstatement at the assertion level relating to an accounting estimate shall include one or more of the following approaches: a. Obtaining audit evidence <u>that may be available</u> from events occurring up to the date of the auditor's report. In doing so, the auditor shall evaluate any changes in circumstances and other relevant conditions between the event and the measurement date that may affect the relevance of such evidence, <u>together with either (b) or (c):</u> b. Testing how management made the accounting estimate and developed related disclosures about estimation uncertainty. In doing so, the auditor's procedures shall address whether: i. The method selected is appropriate, including any changes from the prior period; ii. The significant assumptions and data are consistent and appropriate, and their integrity maintained in applying the method; iii. Management has the intent to carry out specific courses of actions; iv. The judgments made in selecting these give rise to indicators of possible management bias, and if possible indicators of bias are identified, evaluate the implications for the audit, including determining whether there is an intention to mislead such that it is fraudulent in nature; v. Changes from prior periods are appropriate; vi. The data is relevant and reliable in the circumstances; and vii. Calculations are mathematically accurate and whether judgements have been applied consistently; or c. Developing an auditor's point estimate or range. In doing so, the auditor shall: i. Evaluate whether the methods, assumptions or data used are appropriate in the context of the applicable financial reporting framework; and ii. Determine that the range includes only amounts that are supported by sufficient appropriate audit evidence.	Added language to lead-in to make conditional on 7.4.16A and made two amendments to (a) to address that there may still be some evidence available from events after the balance sheet date, but not sufficient to allow the auditor to follow 7.4.16A such that you would also need to obtain evidence from following (b) or (c) i.e., the final outcome of the estimate is not yet known.

Appendix 3 - Detailed Comments

Draft Standard

The section below sets out our other observations and editorial comments by paragraph within the ED. These comments are intended to be read in addition to our overarching comments in our cover letter and appendices 1 & 2 regarding the need for more extensive revisions to the requirements of the standard to better distinguish the ISA for LCE from the ISAs.

- Paragraph 7.4.17 - We suggest EEM is necessary to support an understanding of relevant considerations for the auditor in relation to the concepts of estimation uncertainty and selection of a point estimate. Consideration should be given to including elements of paragraphs A110-A113 of ISA 540 (Revised).
- Paragraph 7.4.18(a) - If our changes described in appendix 2 are not supported, we believe this requirement is missing a core part of the obligation for the auditor - to evaluate whether the audit evidence is sufficient and appropriate. We recommend amending the requirement to state: “Obtaining audit evidence from events occurring up to the date of the auditor’s report. In doing so, the auditor shall evaluate whether the audit evidence is sufficient and appropriate, taking into account any changes....”.
- Paragraph 7.4.18(b) - We suggest that a minimum level of EEM necessary to support consistent and effective application of this requirement would include paragraphs A102, A106 and then A95 and A96 of ISA 540 (Revised). These paragraphs address concepts most likely to be relevant to accounting estimates of an LCE.

6. Public Sector Organizations

Auditor-General of New Zealand

Part 7 – Responding to Assessed Risks of Material Misstatement

Paragraph: 7.4.8(b) and 7.4.16 to 7.4.18

Observation: There is an element of duplication in these requirements.

Possible Correction: Remove the duplication and include all requirements on accounting estimates under one heading.

7. Professional Accountancy and Other Professional Organizations

Finnish Association of Authorised Public Accountants

We present below some detailed comments about the different Parts of the draft standard that could, in our opinion, be streamlined further without compromising reasonable assurance and quality audit. We suggest that the IAASB increases alternativeness and the use of professional judgement in deciding whether a requirement is relevant or efficient in the circumstances. One should always consider the value of the procedure/requirement to the ultimate goal of the audit – a reasonable assurance on that the financial statement does not include material misstatements – not to the audit process. Our comments are given mainly from the Finnish point of view (low audit thresholds, big number of SMEs, big number of audits conducted entirely at once, big number of remote audits etc.) and they aim to the appropriateness of the standard in regard to an SME audit.

7.4.17 Accounting Estimates

In LCEs, the presumption is that there are no complex estimates. In the audits of most SMEs the procedures in paragraph 7.4.17 add no value to the audit. It should be removed.

Institute of Chartered Accountants in England and Wales

7.4.18: in the vast majority of cases, only (a) applies. Where it does not provide sufficient appropriate audit evidence, (b) or (c) may be needed but not both. 7.4.17 should be folded into this paragraph.

Korean Institute of Certified Public Accountants

Requirements concerning accounting estimates involving ‘complex modeling’

According to paragraph 137 of Explanatory Memorandum, if a complex accounting estimate is discovered that involves complex modeling, the use of the ISA for LCE shall be immediately excluded for this sole reason, because it was not considered in design of the ISA for LCE. This is a disproportionately strict requirement considering that, according to paragraph A.9 of Explanatory Memorandum, the matters described in the list are intended to be considered both individually and in combination. The presence of one characteristic exhibited by an entity does not necessarily exclude the use of the [draft] ISA for LCE for that entity.

Paragraph 137 of Explanatory Memorandum explains that such strict requirement is included because ‘complex modelling’ was not considered in design of the ISA for LCE. However, in some exceptional cases, accounting estimates involving complex modelling can be discovered in an entity that has all the other characteristics of LCE. Thus, ‘complex modeling’ should also be considered in combination in the same manner as how other matters are treated, instead of excluding the use of the ISA for LCE completely just because of the presence of one such characteristic. There is no need to treat complex modeling differently from other qualitative characteristics.

Therefore, we want the ISA for LCE to be amended in a way that ‘complex modeling’ can be considered in combination in the same manner as other qualitative characteristics are considered. For example,

- I. Requirement concerning complex modeling can be included in the ISA for LCE
‘Complex modeling’ could be considered in combination without excluding the use of the ISA for LCE immediately if the requirement concerning ‘complex modeling’ had been considered in the design of the ISA for LCE. ‘Complex modeling’ ends up becoming a very strict requirement as a result of not including it in the ISA for LCE.

There is a substantial downside caused by not including the requirement concerning complex modeling in the ISA for LCE. However, including the requirement in the ISA for LCE doesn’t increase burden on auditors as it shall only apply in the presence of such modeling. We propose that the requirement concerning complex modeling should be included in the ISA for LCE. With all due respect, we ask for your reconsideration.

- II. Reference to ISAs can be allowed in limited circumstances (see the answer to Question 1).

Pan-African Federation of Accountants (PAFA)

Editorial to paragraph 7.4.18.(a)-(b):

Formatting: It appears as if the spacing of the paragraphs are different to the rest of the document and appears to be “aligned left” rather than “justified”. It is suggested that it be corrected.

South African Institute of Chartered Accountants (2)

92. The IAASB should consider the probable impact of the nature of accounting estimates pertaining to LCEs being less complex on the applicability and relevance of all of the ISA 540(Revised) requirements on the audits of LCEs.

Specific Questions\Section 4E – Content of ED-ISA for LCE\Question 9- Views on the content of Parts 1 through 8 of ED-ISA for LCE\2) Responses on Parts 1 through 8\Part 7\ b. Specific Drafting Comments\7.6 Specific Communication Requirements

4. National Auditing Standard Setters

Austrian Chamber of Tax Advisors and Public Accountants (KSW)

Due to its general importance, we recommend including important guidance of ISA 260.A10 as EEM to section 7.6. In order to have communication requirements in one place we recommend consolidating section 7.6. into section 8.8.

7. Professional Accountancy and Other Professional Organizations

Finnish Association of Authorised Public Accountants

We present below some detailed comments about the different Parts of the draft standard that could, in our opinion, be streamlined further without compromising reasonable assurance and quality audit. We suggest that the IAASB increases alternativeness and the use of professional judgement in deciding whether a requirement is relevant or efficient in the circumstances. One should always consider the value of the procedure/requirement to the ultimate goal of the audit – a reasonable assurance on that the financial statement does not include material misstatements – not to the audit process. Our comments are given mainly from the Finnish point of view (low audit thresholds, big number of SMEs, big number of audits conducted entirely at once, big number of remote audits etc.) and they aim to the appropriateness of the standard in regard to an SME audit.

Paragraph 7.6.3 is too long and unclear. It would be easier to understand and translate if it was split into two sentences. Taking into account that there shouldn’t be complex accounting estimates, we would suggest removing the requirement.